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CATCHING-UP, FALLING-BEHIND AND THE ROLE OF FDIs

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2.1 INTRODUCTION

As discussed in the previous chapter, the global growth process is rather heterogenous. There may be certain clubs of countries with similar growth experiences like catching-up clubs or groups that are falling behind. Many African countries experienced a process of relative divergence towards the leading individualized country group. Some Sub-Saharan countries suffered from even decreasing per capita income. This chronic failure of economic growth during the last two decades was not typical for Africa. As Collier/Gunning (1999) point out, in the 60s, Africa's growth prospects were encouraging. By 1950 Africa had overtaken Asia and between 1960-73 a booming economy was going along with decolonialization. Today, 32 countries are poorer now than in 1980. Today, Africa is the world's region with the lowest income. Looking at these facts many contributions in the literature try to identify the obstacles for a dynamic growth in Africa. What caused the decline in growth rates? Internal and external factors as well as policy made problems and exogenous destinies are suggested. Sachs/Warner (1997) and Gallup/Sachs (1999) emphasized adverse external destiny factors for African people like the fact of being atypically landlocked or an adverse climate. Others like Collier/Gunning (1999) stress more on poor or even counterproductive domestic policy activities. And Ndulu/O'Connell (1999) or Deaton (1999) try to identify some interactions between external factors and negative domestic policy outcomes. In this book we will not be able to conclude in this discussion. Our interest is more limited. We just focus on the role of FDIs for the development process in (South) Africa. Therefore, before turning to the more micro and firm oriented chapters it seems favorable to introduce a short theoretical model which may give an idea of the major development mechanisms and the effects of the domestic factors as well as FDIs on the catching-up process.

*The theoretical model of this chapter traces back to Gries (2002)

The theoretical model of this chapter will focus on three problems:

(i) We must introduce a model with a stylized development mechanism, which captures the empirical observed regimes of catching-up as well as falling-behind. That is, the model should allow to identify the conditions for a switch from stagnation to dynamic upgrading.

(ii) The model should clearly distinguish between the contributions of domestic factors and external factors on growth and development.

(iii) The model should be able to identify the effects of FDIs on the development process and draw a general picture of the potential role of FDIs for development.

In our model the developing economy will be modeled as a small open economy in the economic neighborhood of industrialized countries. The human resources of the economy are defined as the major domestic factor of production. For simplicity this human factor will be called human capital. Even if - as Schultz (1999) pointed out - the literature on aggregate evidence of human capital returns to growth has a number of shortcomings, there is little doubt, that "...the available evidence does tend to show that higher initial levels of education tend to be associated with more rapid subsequent growth." Schultz (1999 p.72.) Further, in our model human capital stands for a broad concept of human abilities as discussed by Schultz (1999). Human Capital is the central domestic economic factor. There are two sectors, a final good sector and R&D sector. As the country is backward the R&D sector is describing the imitating process. In other words, the process is not a research and developing process as it is known in an industrialized country. Imitation includes all learning and spill over effects that are leading to increasing productivity on aggregate.

The presence of foreign firms, and their communication and exchange with the domestic economy is the channel of foreign know how and new ideas in the domestic imitation process. Therefore, foreign direct investments, human capital and technological spill over effects are important factors for the production of the final good as well as for the imitation of technologies. Successful catching-up requires the closing of the technological gap towards the leading countries of the industrialized world. Like the new growth theory this paper emphasizes the importance of technological diffusion and the accumulation of human capital as the main sources of income growth. Technological diffusion through direct investments and the ability to use technologies in production determine growth opportunities.