

## **Foreign Direct Investment and Extractive Institutions** **Lessons from Latin America**

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### **Abstract**

There is a significant debate underway regarding the risks and rewards of foreign direct investment (FDI) for countries in the Global South. These discussions are particularly relevant to the people of Latin America, where the use of inward FDI as a mechanism to support economic development has had dramatic results, both positive and negative. One of the key works in the study of FDI is Robert I. Rotberg's argument that FDI is critical to support the development of weak states; however, the applicability of this theory faces difficulty in the context of Latin America, where middle-income countries have extractive institutions (Rotberg, 2002). I use the cases of Mexico and Peru to demonstrate that for middle-income countries, extractive institutions can hamper the rewards of FDI and even exacerbate development problems or create new ones. In this regard, the sector of FDI will determine the nature of the impact. In states with extractive institutions, FDI in the natural resource sector is prone to stimulating social conflict. In states with extractive institutions, FDI in the manufacturing sector begets a situation of stagnated development, as the jobs that are introduced are of poor quality and low wages.

### **Introduction**

There is a significant debate underway regarding the risks and rewards of foreign direct investment (FDI) for countries in the Global South. These discussions are particularly relevant to the people of Latin America, where the use of inward FDI as a mechanism to support economic development has had dramatic results, both positive and negative. Research into the negative impacts of FDI in Latin America has highlighted certain relationships between the institutions of the state and the sector of FDI. The nature of institutions is critical to understand the negative impacts of FDI. As Francis Fukuyama contends, at the root of political crises, such as corruption or authoritarian regression, are flawed political institutions (O'Neil & Rogowski, 2011).

One of the key works in the study of FDI is Robert I. Rotberg's argument that FDI is critical to support the development of weak states; however, the applicability of this theory faces difficulty in the context of Latin America, where middle-income countries have extractive institutions (Rotberg, 2002). As Daron Acemoglu and James A. Robinson (2012) have previously argued in the cases of Mexico and Peru, institutions play a significant role in determining the outcomes of FDI. Focusing on the extractive institutions of Latin America, I argue that for middle-income countries, extractive institutions can hamper the rewards of FDI and even exacerbate development problems or create new ones. In this regard, the sector of FDI will determine the nature of the impact. In states with extractive institutions, FDI in the natural resource sector is prone to stimulating social conflict. In states with extractive institutions, FDI in the manufacturing sector begets a situation of stagnated development, as the jobs that are introduced are of poor quality and low wages. In order to support this hypothesis, I examine the experiences of Mexico and Peru.

The FDI cases in Mexico and Peru demonstrate the sector specific impacts of FDI in middle-income countries with extractive institutions. The following demonstrates that in Peru, which relies on FDI in the natural resource sector, large-scale foreign mining activity has resulted in poverty and displacement for local populations and when they resist, large-scale popular mobilization efforts and violent conflicts ensue. In Mexico, I analyze how FDI in the manufacturing sector has resulted in stagnated wages, poor quality jobs, and an increase in economic inequality.

This paper begins with an introduction to the key theories that relate to institutions and extractive economies. The bulk of the essay is divided between the two case studies: first titled, Peru's Natural Resource Extraction; and second, Mexico's Manufacturing. The conclusion offers a brief summary of the findings and their implications, as well as presents some final thoughts for further research.

### **Theoretical Engagement**

According to the Balance of Payments Manual established by the United Nations Conference on Trade and Development, FDI refers to an investment made to acquire lasting interest in an enterprise operating outside of the home country of the investor (2017). For the investor, the purpose of FDI is to gain an effective voice in the management of the enterprise (United Nations, 2017). Those who promote FDI praise the mechanism of international commerce because of its economic benefits, which include: positive impacts on economic growth through the transfer of expertise; the accumulation of investment funds; and, the upgrading of labor standards (Farlaa, de Crombrughea & Verspagenb, 2016). Since the mid 1990s, FDI has been the main source of external finance for developing countries and is more than twice the size of official development aid (Kosová, 2010).

In his article *The New Nature of Nation-State Failure*, Rotberg suggested that supporting FDI is critical to stave off state failure and promote development (2002). The challenge with this argument is that FDI has complicated and nuanced impacts on a country. When evaluating whether FDI writ large is beneficial for state development, the process becomes more critical when one alters the context of Rotberg's argument from weak states to those in the middle-income category. In middle-income countries, the quality of life is generally better than in weak states; therefore, the standards for conducting impact evaluations are higher.

The theory proposed by Rotberg does not acknowledge the significance of different sectors of FDI and how institutions of the state may influence the impacts of a particular investment (2002). It is important to recognize the role of institutions that regulate FDI and which ensure a just distribution of the benefits that FDI brings. According to the Gross Domestic Product (GDP) data in Mexico and Peru, Rotberg's theory that FDI supports economic development has been correct; however, there is more to consider than economic growth when evaluating the impacts of FDI on a country (World Bank 2019; World Bank 2019b). As this article demonstrates, some factors that should be considered when evaluating the impacts of FDI include population displacement, rates of violent conflict, income inequality, and environmental impacts. The institutions of the state and the sector of FDI matter greatly in determining whether the FDI will have a positive or negative effect on local populations.

Acemoglu and Robinson are two of the leading voices on the roles of institutions in determining the success or failure of states. According to Acemoglu and Robinson, countries such as Great Britain became rich because their citizens overthrew the elites who controlled power and established inclusive political institutions, which vest power amongst the population, involve the citizenry in the democratic process and hold the government accountable to the citizens (2012). Similarly, inclusive economic institutions allow and encourage participation of the masses in economic activities based on those that make the best use of their talents and skills (Acemoglu & Robinson, 2012). In other words, Acemoglu & Robinson (2012) argue that inclusive institutions are those which allow individuals to make their own decisions about their work lives.

Acemoglu and Robinson contend that to be inclusive, economic institutions must include the following: secure private property, an unbiased system of law, and the availability of public services that provide a level playing field amongst the population (2012). These three features facilitate trust and create incentives for citizens to pursue economic goals and achieve success in the long term. Inclusive economic institutions ensure an equitable distribution of resources, facilitating the continuation of inclusive political institutions (Acemoglu & Robinson 2012).

Conversely, extractive institutions prevent a broad swath of the population from meaningfully participating in political or economic affairs. The concept of extractive institutions- structures that allow elite minority groups to extract resources from the majority, often failing to protect property rights or provide incentives for economic activity- is critical to this piece (Acemoglu & Robinson, 2012). Extractive political institutions concentrate power in the hands of a few who are incentivized to maintain and develop extractive economic institutions for their benefit (Acemoglu & Robinson, 2012). Extractive economic institutions function by steering economic rewards toward a small elite; this is done by discouraging the masses from embarking on economic initiatives, by limiting the possibility of achieving their goals, or by narrowing the opportunities to achieve their economic goals (Acemoglu & Robinson, 2012). In the context of FDI, extractive institutions allow investors to take advantage of an inconsistent and flawed regulatory body in order to exploit the people and/or the land, enjoy legal immunities, as well as co-opt state actors, including police and military forces, as their own security personnel to safeguard their investment, which often translates to government violence against civilian populations (Acemoglu & Robinson, 2012).

In Latin America, national institutions were determined by colonial experiences. For the former colonies of Spain, the colonization was based on exploitation versus the settlement processes which took place in British North America (Acemoglu & Robinson, 2012). Colonization of exploitation is defined by the act of conquering a country to exploit its population as labour and its natural resources as raw material (Prevost & Vanden, 2018). Settler colonialism, on the other hand, involves conquering a country to establish a vassal of the empire in which members of the motherland will live permanently (Acemoglu & Robinson, 2012).

In the former Spanish colonies, economies and societies were based on the exploitation of indigenous people (Acemoglu & Robinson, 2012). Monopolies were established to secure the wealth of the conquistadores, which blocked the economic incentive

of the greater population (Acemoglu & Robinson, 2012). These institutional frameworks designed to protect the interests of the minority elite continue today in the former colonies. In Mexico and Peru, extractive institutions have meant unreliable protection of private property, a biased legal system, and a lack of public services that ensure equitable opportunities for employment (Acemoglu & Robinson, 2012).

To highlight the economic impacts of extractive institutions, an average US citizen is seven times as wealthy as an average Mexican and more than ten times as a Peruvian (Acemoglu & Robinson, 2012). Acemoglu and Robinson (2012) explain this wealth disparity as a result of the extractive economic institutions, which hamper the development processes of Mexico and Peru. How political bodies contend with these extractive economic institutions matters greatly in designing their approaches to economic development. As Rotberg (2002) contends, FDI can be a meaningful avenue to support economic development; however, the sector of FDI, as well as the institutions of the state, matter immensely in the process of implementing an FDI lead approach to development.

When examining the negative impacts that FDI have had on Peru, the temptation might be to dismiss the situation as just another case of the resource curse or the paradox of plenty as described by Terry Lynn Karl (1997); however, there are important institutional factors that require consideration. In her seminal work, *Paradox of Plenty: Oil Booms and Petro-States*, Karl argues that resource dependence leads to disproportionate fiscal reliance on resource rents and public spending, at the expense of statecraft. According to Karl, resource booms create the illusion of prosperity and development, while destabilizing regimes by placing a higher priority on resource interests, than strengthening state capacities (1997). In the case of mining economies, such as Peru, the structure of the economies impedes state development because public administration is concentrated in enclaves rather than extended throughout the country (Karl, 1997). Similarly, the private sector fails to diversify and develop productive capacities (Karl, 1997). Since Karl wrote *Paradox of Plenty*, there has been significant debate in the literature around the nature of the supposed resource curse.

Research conducted by Michael Ross builds off the work of Karl to determine if and how oil and minerals impacts democracy. With the use of quantitative data from over 100 countries, Ross demonstrates how the presence of oil and mineral wealth leads to a decline in democracy in countries, where income rates are low upon resource extraction (2001). Ross explains this negative correlation between resource rents and democracy, in part, as a product of a lack of taxation (2012). Resource rent allow states to develop wealth without needing to tax their citizenry. Ross argues that when citizens do not pay taxes, they are less likely to demand public services and accountability from political leaders; consequently, leaders are enabled to be more authoritative and/or corrupt with lesser risk of public uprising (2012).

I agree with Ross (2012) that populations need to be able to hold their political leaders accountable; however, there is another important dimension to ensure political accountability and that is to strengthen political institutions. The political institutions of a nation determine the ability of its citizens to hold politicians accountable to their constituents and influence policies. Subsequently, this relationship is what determines whether politicians are agents of the citizens or can abuse the authority vested in them

(Acemoglu & Robinson, 2012). One of the main lessons to be learnt from studying the relation between institutions and FDI is that the resource curse should not be regarded as an unavoidable destiny; rather the challenge for domestic policy makers, is to adopt institutions that better regulate FDI and distribute the wealth that come with natural resources.

### **Peru and Natural Resource Extraction**

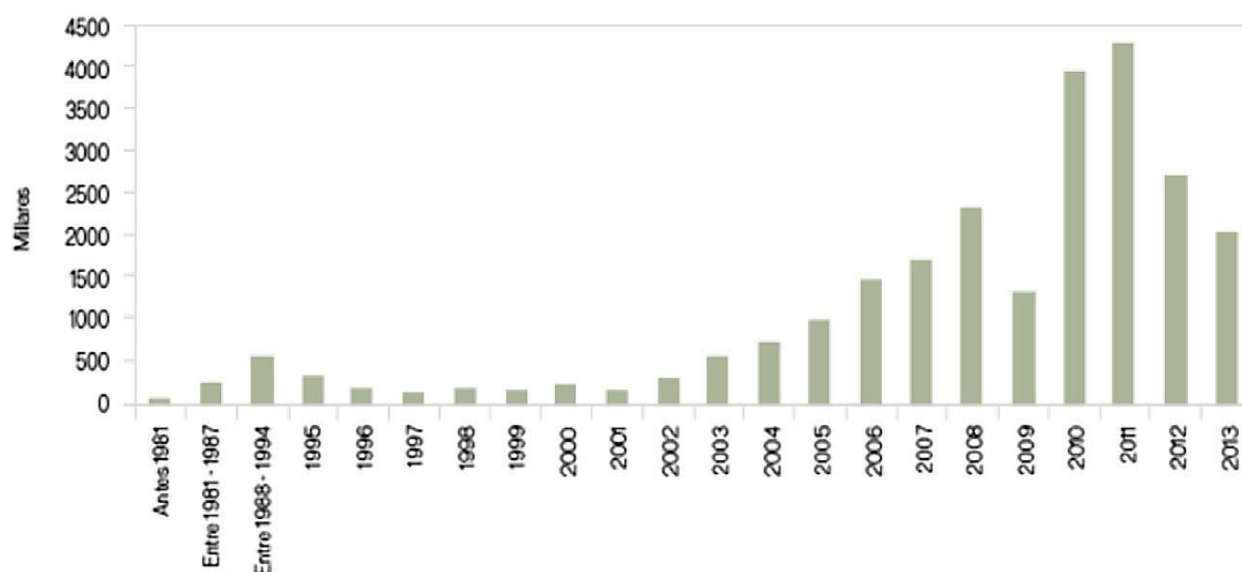
In 2018, the total stock of FDI in Peru stood at 104 billion (USD), representing 46.4% of the GDP (United Nations, 2019). In 2015, FDI inflows represented 17.7% of gross fixed capital formation<sup>1</sup> (Banco Santander, 2017). The majority of that figure was represented by investment in the natural resource sector at 38%, the bulk of which was in mining (Peru's Private Investment Promotion Agency, 2015). Cumulatively, therefore, FDI in the natural resource sector represented 4.6% of GFCF. The next top industries are finance, and communications, which in 2015 each only represented 18% of inflowing investment (Private Investment Promotion Agency, 2015). Investment in extractive natural resources is by far the most important source of FDI in the country. The problem in Peru is that with such a high degree of reliance on one sector of FDI the state does not have adequate political institutions to mitigate the political power of foreign investors.

During the 1990s, under the leadership of Alberto Fujimori, Peru began its neoliberal transformation, which included: embracing policies of privatisation, reduction of public expenditures, providing tax benefits for extractive industries and eliminating trade barriers (Merino Acuña, 2015). The investment positive environment created under Fujimori has facilitated the extractive exploitation of areas that were formerly preserved as frontier zones; however, with the rise in the number of concessions in the Andes and the Amazon, many of these protected areas have been bought and sold by foreigners (Merino Acuña, 2015). At the beginning of the 1990s, prior to Fujimori's neoliberal economic revolution, mining concessions covered 2,300,000 hectares, but by 2011 they consumed over 24 million hectares, in other words, 19% of Peru (Merino Acuña, 2015). Figure 1 demonstrates the amount of land dedicated to mining concessions in Peru, from 1981-2013. This concentration of both wealth and land ownership brings with it immense power imbalances in rural Peru between foreign companies and communities.

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<sup>1</sup> The Organization for Economic Cooperation and Development defines gross fixed capital formation (GFCF) as follows: a macroeconomic concept used in official national accounts such as the United Nations System of National Accounts (UNSNA), National Income and Product Accounts (NIPA) and the European System of Accounts (ESA). Statistically it measures the value of acquisitions of new or existing fixed assets by the business sector, governments and households (excluding their unincorporated enterprises) less disposals of fixed assets. GFCF is a component of the expenditure on gross domestic product, and thus shows something about how much of the new value added in the economy is invested rather than consumed (Organisation for Economic Co-operation and Development, 2006).

Figure 1: Acreage Granted to Mining in Peru 1981-2013 (Paredes, 2016)



The 2004-2009 global commodities boom was a significant period in Peru's economic history. The boom simultaneously generated economic growth of 9.8% in 2008, while encouraging increased investment in the mining sector over the following years (Arellano-Yanguas, 2011). From 2002 to 2007, there was a 12% overall increase in FDI; however, the stock of FDI in the mining sector increased by more than 64% (Arellano-Yanguas, 2011). During the same period, the sector's contribution to internal tax revenue increased from 5% to 29% and the amount of people nation-wide living below the international poverty line was reduced from 54% in 2002 to 36% in 2008 (Arellano-Yanguas, 2011).

Despite the positive economic growth that has occurred under the neoliberal reforms of recent governments, these regimes have not been popular in rural Peru, as the rate of violent conflicts in the mining regions have soared and have come to represent a genuine threat to national political stability (Arellano-Yanguas, 2011). For nations with extractive economic institutions, FDI in the natural resource sector tends to support foreign investors and domestic elites, with tremendous negative consequences for local populations. Javier Arellano-Yanguas (2011) contends that Peru's economic development approach of promoting ultra-high levels of mineral exploitation has created an environment of rural disdain for the government, which has led to episodes of a large-scale violent revolt against the state.

In the case of Peru, where mining takes place in remote rural areas far away from the eyes of the media, there have been incidents of forced mass displacement of indigenous populations and violent repression carried out by both official and unofficial agents of the state (Merino Acuña, 2015). The Tintaya mining operation, owned by Anglo-Australian conglomerate BHP, is a site of recent displacement of indigenous villagers. In expanding the mine's tailings dam, BHP had several communities relocated, triggering protests and violent conflict (Gamau & Dauvergne, 2018). The Yanacocha gold mine in Cajamarca is another case of a protracted conflict between a foreign mining company and local people. Following the approval of Newmont's Conga concession, protests and violent conflicts escalated (Gamau & Dauvergne, 2018). Between 2011 and 2012, clashes between protesters, state officials and private security resulted in the deaths of five local people and hundreds of injured (Gamau & Dauvergne, 2018).

Displacement and conflict have contributed to increased regional poverty and inequality in Peru (Merino Acuña, 2015). Displaced people typically relocate to the slums of nearby cities, where they find new means to sustain themselves and their families in the informal economy (Gamú & Dauvergne, 2018). Within the cities, the influx of internal migrants and rising urban incomes generated by mining has induced inflation (Gamú & Dauvergne, 2018). Rising inflation exacerbates the effects of income loss and poverty—particularly for those who cannot be incorporated into the new extractive economy (Gamú & Dauvergne, 2018).

During the first two years of his 2006 to 2011 term in office, Peruvian President, Alan García championed 99 decrees to break up community land in order to pursue foreign investment agendas in natural resource exploitation (Jakoski, 2014). Under President Ollanta Humala, who governed from 2011-2016, the government consistently took the side of the foreign investors in mining conflicts (Jakoski, 2014). Political preference for foreign mining investment over local people continued under President Pedro Pablo Kuczynski, who in 2018 resigned amidst a corruption scandal (Human Rights Watch, 2019). The assumption is that this trend will remain more or less the same under the current pro-business President Martín Vizcarra (Garda, 2019).

In the Fraser Institute's Annual Survey of Mining Companies, Peru has unfailingly ranked among the most attractive countries in terms of the economic potential of its mineral reserves, yet it ranks very low in political variables, including security, political stability, and conflicts over land (Arellano-Yanguas, 2011). When analyzing the relationship between mining and conflict in Peru, the high level of influence of foreign business over the state represents an observable link. The key factor that has enabled foreign investors to become such a powerful force in Peru are the extractive political institutions that do little to limit the influence of foreign investors over the state.

In Peru, mining companies have extraordinary power and influence over political actors because of the high level of investment and the nature of their extractive institutions. The power of foreign mining companies in Peru is exemplified by the current tax regime for the mining sector. In Peru, new mining operations are not required to pay the standard 30% profit tax until they have recovered their initial investments (Arellano-Yanguas, 2011). Furthermore, the government does not have the right to change the mining tax regime without the companies' consent (Arellano-Yanguas, 2011). More recently, President García formed an agreement with the mining companies, which excludes them from having to pay royalties and windfall taxes (Arellano-Yanguas, 2011). The agreement also encourages mining companies to make voluntary contributions to the communities they have ongoing projects in; however, these processes are governed very loosely by the state (Arellano-Yanguas, 2011). This agreement is a clear indication of the subordination of the Peruvian government to mining interests.

Rotberg's (2002) argument in support of FDI as a development tool, does not seem to hold up in the case of Peru, where FDI in mining has meant increased poverty and displacement of rural people, violent conflict and large-scale mobilization against the state. In Peru, the required mechanisms to ensure transparent use and distribution of funds generated from mining are weak and infrequently applied (Bebbington & Bury, 2009).

Other institutional challenges include barriers to reorient mineral wealth for human development purposes and environmental sustainability (Arellano-Yanguas, 2011). These institutional constraints have contributed to social unrest, driven by grievances, fear and uncertainty in localities where mining expansion has taken place. The fact that such unstable environments are so widespread throughout rural Peru is reflective of the political power of the foreign companies that benefit from the system that prioritizes their interests first, as well as a central government, which is committed to institutions that promote FDI in the extractive natural resource sector as a pathway to economic growth.

### **Mexico and Manufacturing**

There have also been cases of forced displacement in southern Mexican mining communities. According to reports from the inhabitants of the La Colorada community in Chiapas, the Canadian mining company Panamerican Silver, colluding with state officials, had local people illegally evicted from their homes after harassing and threatening them for two years (Valadez Rodríguez, 2017). Such cases have been known to take place in Mexico; however, these incidents are less common than in Peru and typically occur on a smaller scale. One of the important reasons for this is that the Mexican economy is less dependent on mining investment than in Peru. In 2017, the mining industry in Mexico—the only natural resource sector in the top five industries of FDI inflow—only represented 4.7% of all FDI (Banco Santander, 2017). Consequently, FDI inflow in mining only represented 0.4% of GFCF. FDI is important to the Mexican economy; but it is the manufacturing sector, which receives the most investment.

FDI has been a critical component of the Mexican economy since its 1986 adoption of neoliberal economic growth strategies (Goldstein, 2010). One of the chief goals behind this policy shift was a desire to increase the competitiveness of the manufacturing sector, which would subsequently stimulate economic growth and industrial restructuring for the entire Mexican economy. Furthermore, according to Andrea Goldstein, the Mexican government hoped FDI in manufacturing would improve environmental practices, through the transfer of foreign technology and better management skills (2010). The North American Free Trade Agreement (NAFTA) has played an influential role in incentivizing US and Canadian FDI in the Mexican manufacturing sector. In the first ten years of NAFTA (1995-2005), national productivity of labour grew 25.6%, which is mostly attributed to the increase in FDI in manufacturing (Balakrishnan & Elson, 2011). By 2016, Mexico's FDI inflow represented 11.1% of GFCF. Of that figure, 61.3% of inflows was in the manufacturing sector (United Nations, 2016). Therefore, inflow of investment into the manufacturing sector represented 5.5% of Mexican GFCF.

Between the third quarters of 2007 and 2014, Mexico's GDP growth of 1.9% was a result of the 1.6% increase in employment, most of which was in the manufacturing industry (Dussel Peters & Ortiz, 2015). Over the same eight-year period, manufacturing GDP increased by 1.6%, which was primarily intensive growth, represented by a 1.2% rise in labor productivity (Dussel Peters & Ortiz, 2015). From a short-term perspective, the GDP of the total economy grew in this period at a rate of 2.2% (Dussel Peters & Ortiz, 2015). This is largely a reflection of the 1.9% growth in labor productivity and 2.6% increase in employment, both of which were due to FDI in the manufacturing sector (Dussel Peters & Ortiz, 2015). For Mexico, FDI in the manufacturing sector has contributed to economic growth, but it has not been without its weaknesses as a developmental mechanism.



One of the common criticisms regarding FDI in Mexico's manufacturing sector is that wages in the sector have stagnated. From 2007-2013, growth in labor productivity was not accompanied by a growth in real wages in 45/86 manufacturing branches (Dussel Peters & Ortiz, 2015). Furthermore, in 12 manufacturing sub-sectors, productivity growth was higher than the growth of real average remunerations (Dussel Peters & Ortiz, 2015). The gap was particularly wide in the metal and electronics subsectors with a 5% and 4.7% gap between rates of productivity and real wages (Dussel Peters & Ortiz, 2015).

As a whole, from 1994-2011 real wages in Mexico decreased by 8.2% (Balakrishnan & Elson, 2011). Though the 1995 financial crisis likely contributed to this fall, by what degree, unfortunately, remains unknown (Cabrera, 2015). What is better understood is that, for the most part, by 2004 the Mexican economy had recovered from the recession, yet the manufacturing real wage had not returned to 1994 levels (Cabrera, 2015). Only in recent years has the real wage rate caught up to where it was pre-NAFTA (Weisbrot et al., 2017). Even in 2016, real wages were just 4.1% above the 1994 level, and barely above the levels during the 1980s (Weisbrot et al., 2017). What one can learn from this data is that since the increase in US and Canadian FDI in the manufacturing sector, wages have effectively stagnated in Mexico. The more than a decade long trend of wages lagging behind productivity growth, suggests that there is ample room for the manufacturing branches to raise the real minimum wage based on the growth of labor productivity.

One of the leading explanations for this stagnation in wages relates to the lack of improvements in the quality of public education (Nash, 2001). In a study by the Organization for Economic Cooperation and Development, researchers found that the Mexican public education system suffers from serious quality problems (OECD, 2016). The Program for International Student Assessment deems Mexico to have below average scores for middle-income countries in science, reading, and mathematics (OECD, 2016). These deficits in public education have ill-equipped the workforce for a better-paying, technologically advanced manufacturing sector, involving such industries as cellphone or computer microchip production. In the case of Mexico, Acemoglu and Robinson contend that the low education levels are caused by economic institutions, which fail to create incentives for parents to educate their children, and by political institutions that fail to encourage the government to support schools and the wishes of parents and children (2012).

A further explanation for the wage stagnation in the Mexican manufacturing sector is provided by Tyler Cowen. Research conducted by Cowen (2017) demonstrates that wage stagnation in the manufacturing sector is not unique to Mexico, but rather has been experienced globally and that the trend can be explained by technological developments, replacing the need for high skill employees. However, his explanation for wage stagnation does not offer a holistic depiction of the factors at play in Mexico, where the government actively suppresses wage increases to maintain its competitive advantage in manufacturing over the US (O'Brien & Williams, 2016). If the Mexican government was to embrace an increase in real wages, then manufacturing operations would likely either return to the US or go to Asia (O'Brien & Williams, 2016).

Another important issue that the FDI in the manufacturing sector faces is that it has not proven to be an effective mechanism to support the right to just and favourable

conditions of work for the middle and lower classes. Even though manufacturing jobs in the expanding Mexican automotive industries offer consistent and reliable wages at rates that keep employees above the international poverty line (Downer, 2011), manufacturing jobs brought about by Canadian and US foreign investors rarely include social benefits, such as health coverage, sickness/disability leave or vacation time (Hansen-Kuhn & Hellinger, 2003). In fact, since NAFTA, the total number of Mexicans working without employment benefits has risen (Vidal, 2014). The housing situation provided to those workers who relocate to urban centers following employment opportunities in the burgeoning manufacturing sector are regularly overcrowded, consisting of substandard dwellings, such as trailers, sheds, and garages (Vidal, 2014).

FDI in the manufacturing sector has produced few linkages with the domestic economy, which in turn limits the potential to mechanize FDI as a catalyst for higher productivity and stronger corporate capabilities. The foreign manufacturing sector is largely disconnected from the domestic economy as a result of its reliance on cheap labor and imports for productive inputs. Alberto Arollo Picard (as cited in Hansen-Kuhn & Hellinger, 2003) describes this occurrence as the development of economic enclaves within the Mexican economy. Following Picard's argument, FDI in the manufacturing sector can be understood as contributing more to the economic inequality than providing benefits to the general Mexican population. In essence, the argument Picard makes reinforces the evidence against the largely disproven theory of trickle-down economics, which contends that by stimulating business investments in the short term it will benefit society at large in the long term (Del Beccaro, 2018).

It is true that FDI in the manufacturing sector has benefited the local economies of a select few northern cities where facilities have been established. The city of Aguascalientes has benefited from FDI more than most cities with a productivity growth of 4.4% per year over the period 2010-16 (OECD, 2018). Still, major investment in manufacturing is devoted to a few companies and these enterprises, as Picard (as cited in Hansen-Kuhn & Hellinger, 2003) describes them, are economic enclaves within the economy, because they offer very few commercial spin-offs for domestic production or for generating a chain of indirect employment. A further problem is that the gains experienced in northern Mexico have not been experienced in the southern region. This inequality has contributed to the historic regional polarization and wealth disparity in Mexico.

## **Conclusion**

The experiences of Mexico and Peru with FDI suggest that Rotberg's argument in support of FDI as a development tool does not stand up in cases of middle-income countries with extractive institutions. The middle-income countries of Latin America have extractive institutions, which limit the political power of the masses and ensure that the gains from FDI are reserved for domestic elites. As Rotberg (2012) contends, FDI can be a meaningful avenue to support economic development. FDI can be an agent for economic development through the transfer of expertise, the accumulation of investment funds, and the upgrading of labor standards; however, the sector of FDI, as well as the institutions of the state, matter immensely in determining the type of impacts the investment will have on the country and its people (Farlaa, de Crombrughea & Verspagen, 2016).

In Mexico, the combination of extractive institutions and FDI in the manufacturing sector has resulted in stagnated wages, poor quality jobs and increased economic inequality. In Peru, FDI in the natural resource sector (on top of extractive institutions) has both directly and indirectly stimulated violent conflicts and large-scale popular mobilization against the government. In Mexico, the primary reason why inequality has grown due to FDI in manufacturing is because of increased enclaves of economic growth in the north, rather than overt impacts that increase poverty in the south. This is unlike Peru, where mining has directly increased poverty by way of displacement and ecological devastation in rural areas.

This article serves as an entry-point for research that focuses on either of the two sectors of FDI, to test whether the negative impacts of FDI in Mexico and Peru are systemic issues for states with extractive institutions or merely anomalies. In order to accomplish this, future research would have to compare a larger set of countries with extractive institutions, which are reliant on either FDI in the natural resource or manufacturing sector.

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