

Chapter 2

Corruption in Latin America and How It Affects Foreign Direct Investment (FDI): Causes, Consequences, and Possible Solutions

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ABSTRACT

Foreign direct investment has aided in a significant manner the economic development of Latin America since the early 1990s because capital in this region is limited (Blanco, 2012). Despite some criticism literature on FDI has overwhelmingly demonstrated that FDI has positive effects on host countries (Tan & Meyer, 2011) especially in Latin America (Wooster & Diebel, 2010). Authors researching the effects of FDI in Latin America have stated that this investment helps to growth on productivity (Blonigen & Wang, 2005) and thus, might help developing countries to begin their road to development. Therefore, scholars have devoted great efforts to understanding the determinants of FDI to Latin America and a brief overview will be provided in this study. This paper will present a detailed account of FDI flows to the region, a clear definition of corruption and how it is manifested in Latin America. After these definitions, suggestions are provided to deal with the problem of corruption in the region.

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1. INTRODUCTION

In this chapter a description of foreign direct investment (FDI) flows, its determinants, and corruption in Latin America will be provided. The rationale for analysing how corruption affects the attraction of FDI to Latin America is due to the size of the region and its substantial FDI inflows, which can provide a clear macroeconomic picture of the issue. Also, all the countries in Latin America are considered developing and thus with high levels of corruption (Except Chile that does not present high levels of corruption but is still considered developing) (Transparency International, 2011). Therefore, this region represents an ideal location to study how corruption affects FDI depending on the corruption levels of the home countries.

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Also, studies have consistently demonstrated that corruption has a detrimental effect on FDI flows. Therefore, studying corruption and its causes in Latin America can be viewed as the first step to start dealing with this problem. This paper will present a detailed account of FDI flows to the region, a clear definition of corruption and how it is manifested in Latin America. After these definitions, suggestions are provided to deal with the problem of corruption in the region.

2. DEFINITIONS

2.1 Foreign Direct Investment (FDI)

Foreign direct investment (FDI) is defined by the Organization for Economic Cooperation and Development (OECD) as “cross-border investment by a resident entity in one economy with the objective of obtaining a lasting interest in an enterprise resident in another economy” (OECD, 2014). By lasting interest the OECD means that a long-term interest and significant influence between the direct investor and the enterprise should exist. Therefore, to be considered FDI, the foreign investor should at least have 10% of the voting power in an investment made overseas.

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