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# DIASPORA DIRECT INVESTMENT (DDI): THE UNTAPPED RESOURCE FOR DEVELOPMENT

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# EXECUTIVE SUMMARY

The development literature is replete with examples of how foreign direct investment (FDI) is beneficial to sustained growth in economically marginal societies. In this paper, we make the case for a new paradigm shift in which Diaspora Direct Investment (DDI) has emerged and improved upon traditional FDI even during a major economic downturn. We draw distinctions between DDI where migrants return to their home society to establish businesses, and FDI while attempting to establish the relevance of DDI to development.

We also briefly discuss diaspora community efforts in countries across several regions of the world. Furthermore, because the success of attracting DDI lies within both home and host countries' institutional framework, this paper offers concrete suggestions for policy reforms for developing governments to accommodate DDI. In doing so, it also offers steps enabling International Financial Institutions (IFIs) to increase the flow of DDI into developing regions.

## **INTRODUCTION**

This paper presents the argument that there is an alternative to foreign direct investment (FDI) in increasing economic growth in developing societies. This alternative, Diaspora Direct Investment (DDI), might serve to alleviate the downturn in investment from G-8 and traditional private sources. DDI is distinct from FDI in that it relies on a transnational social network made up of migrants and migrant mechanisms operating between host and home countries. The migrants are the linchpin because they have a unique knowledge of their homeland and culture. These factors make the migrants a more viable facilitator of capital acquisition and investment. Part One of this paper considers the traditional FDI approach and its shortcomings in development particularly in Africa. Part Two introduces the concepts and ideas that form the foundation of the DDI model. Part Three discusses the roles that DDI may play in improving economic growth in developing societies. Part Four provides several regional examples of DDI activity and its varying degrees of success. DDI is presented as a tool in that it can adjust to national economic and political contexts more flexibly than FDI. Part Five concludes by offering some suggestions for policymakers. Specifically, we suggest reforms for developing country-governments that would accommodate DDI allowing International Financial Institutions (IFIs) to increase capital flows into developing regions.

# DIASPORA DIRECT INVESTMENT (DDI): THE UNTAPPED RESOURCE FOR DEVELOPMENT

## FDI'S ROLE IN DEVELOPMENT

Proponents of foreign direct investment claim FDI spurs growth through foreign entrepreneurs and brings superior technology or business practices that are subsequently adopted by domestic firms. These practices, in turn, increase efficiency and productivity in the economy at large and create welfare benefits for both producers and consumers.

These practices also create complementarities, that is, vertical spillovers that occur when multinationals provide local suppliers and customers with new technology. This is a strategy to build efficient supply chains for multinational's overseas operations, thereby improving the quality and lowering the price of non-labor inputs.<sup>1</sup> Horizontal spillovers take place when local firms observe and imitate practices of foreign investors or domestic employees leave foreign companies to start their own firms, bringing superior technology and know-how with them. In addition, a horizontal spillover can occur when multinational investment encourages the entry of other international companies, such as brokerages and consultancies.<sup>2</sup>

FDI increases the capital stock and brings liquidity to developing countries, many of which have ineffective capital markets and face major liquidity problems.<sup>3</sup> FDI might also improve domestic capacity in research and development (R & D). R&D activities of foreign firms may help strengthen host country capability directly or indirectly by stimulating domestic R&D activities.<sup>4</sup>

More recently, scholars have recognized that FDI not only improves the productivity of a developing countries but it can also improve enterprise profitability. Because of imperfect competition and increasing returns to scale, linkages between foreign investors and local firms can also lead to pecuniary externalities that affect “the profit function via cost reductions or increased revenues.<sup>5</sup> In other words, increased output taps into unsatisfied demand. This increase allows producers to increase their supply at greater efficiency, which in turn lowers domestic prices.

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<sup>1</sup> Blalock, Garrick and Gertler, Paul J. *Foreign Direct Investment and Exernalities: The Case of Public Intervention*. “Does Foreign Direct Investment Promote Development?” Institute for International Development. April 2005. p. 74.

<sup>2</sup> Blalock. p. 77.

<sup>3</sup> Blalock. p. 76-77.

<sup>4</sup> Erdilek, Asim. *R&D Activities of Foreign and National Establishments in Turkish Manufacturing*. “Does Foreign Direct Investment Promote Development?” Institute for International Development. April 2005. p. 108.

<sup>5</sup> Gorg, Holger and Strobl, Eric. *Foreign Direct Investment and Local Economic Development: Beyond Productivity Spillovers*. “Does Foreign Direct Investment Promote Development?” Institute for International Development. April 2005. p. 138.

## THE FAILURE IN ATTRACTING FDI

Societies in Africa, many of which are the least developed in the world, are in desperate need of such investment but unfortunately don't receive it. While FDI has increased overall globally, shares among countries fell and what flows did increase are concentrated in certain countries and sectors. Between 1970 and 2001, FDI to developing countries as a percentage of GDP increased from 0.1 to 3 percent to developing countries. Africa, however, has benefited little from this overall increase<sup>6</sup> because its share of the world's total FDI declined by a half between 1980 and 2000 compared to other regions.<sup>7</sup> Estimates of the African Development Bank (ADB) show that Africa's share of FDI countries over the years has declined from an average 16 percent in the 1970s to 10 percent in the 1980s and 5 percent in the 1990s.<sup>8</sup> UNCTAD's 1997 report shows that slightly over 4 percent of FDI for the developing world went to Africa. The 2007 Credit Crisis brought FDI growth to a halt with only 3 percent average growth in 2009 after previous annual averages of 6 percent from 2004 to 2008.<sup>9</sup>

There are a number of reasons for this steady decline of FDI, some of which are a product of the nature of investment in African countries and others that are explained by policies by African governments. Although most African countries have partially liberalized their economies to foreign investment, in many ways they continue to spurn foreign capital. Most Africans maintain skepticism toward foreign investment owing to historical, ideological and political origins.<sup>10</sup> This skepticism is bound up in African governments' attitude toward foreign capital and manifests itself in economic nationalism and Africanization, or the belief that the state should intervene in order to transfer ownership of firms to locals. Consequently, African governments engage in various practices that directly and indirectly bar FDI, that include legal restrictions on foreign ownership of domestic firms,<sup>11</sup> performance requirements for foreign firms with regard to local partnerships and employment, the maintenance of monopolized industries, state intervention and, occasionally, outright nationalization.

Beyond policies that purposefully deter foreign investment, many African countries have poor business environments that dissuade would-be entrepreneurs. Bureaucratic, regulatory and other informal barriers are difficult to negotiate. Corruption is widespread and political and business elites often collude frequently to the detriment of the foreign investor.<sup>12</sup>

Meanwhile, the little FDI that reaches Africa is focused on extractive industries such as mining. FDI to African countries has been insufficient, highly selective and disbursed only after the extraction of undue concessions, in the form of tax holidays for several years, the growth impact has ostensibly minimal.<sup>13</sup> Owing to these factors that deter

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<sup>6</sup> *World Development Report 2005*.

<sup>7</sup> Lumbila, p. 1.

<sup>8</sup> Bofo-Arthur, Kwame. *Journal of Third World Studies* 20, 2003.

<sup>9</sup> World Bank 2009 estimates.

<sup>10</sup> Moss, Todd J., Ramachandran, Vijaya, and Shah, Manju Kedia. *Is Africa's Skepticism of Foreign Capital Justified? Evidence from East African Firm Survey Data*. "Does Foreign Direct Investment Promote Development?" Institute for International Development. April 2005, p. 337.

<sup>11</sup> Moss, p. 345.

<sup>12</sup> Moss, p. 346.

<sup>13</sup> Bofo-Arthur, Kwame. *Journal of Third World Studies*, 2003.

FDI, Africa is denied easy access to investment that would promote greater levels of economic growth and opportunities to integrate into the global economy.

Notwithstanding the amount of theory that discusses the possible effects of FDI on developing economy, there is still a fundamental debate at the heart of the question on FDI. Does FDI, in fact, accelerate growth? In general, foreign direct investment by multinational companies in emerging markets is perhaps the most controversial part of globalization. Many of its critics argue that foreign companies exploit workers and circumvent labor laws. More damaging from a strictly economic perspective, some firm-level studies of particular countries find that FDI seems to have no significant effect on economic growth. One study of foreign firms in Venezuela between 1979 and 1989 suggests that there were no technological spillover effects from foreign enterprises to domestic firms and therefore no attendant increases in efficiency.<sup>14</sup>

On the other hand, some scholars who adopt a macroeconomic perspective and look at broad cross sections of countries or industries find that FDI does have a positive growth effect, especially when the country has a highly educated workforce or financial markets that allow it to exploit FDI spillovers.<sup>15</sup> All things considered, the efficacy of FDI is not unambiguous and experts on both sides of the argument advance evidence about the value of such investment. In Africa, this is particularly true. According to one report, FDI correlates positively with economic growth in the Ivory Coast, Mauritius, Mozambique, Senegal, Tanzania and Uganda but does not in Botswana, Lesotho and Zambia. Even with the 2007 Currency Crisis, investors are optimistic about the region as foreign money from the China-Africa Development Fund has committed nearly \$400 million and African groups themselves ‘continually plump money into projects ranging from telecommunications to new oil fields’.<sup>16</sup>

However, the general verdict on FDI points towards it being a powerful tool for growth but conditional on factors including the level of education, infrastructure and institutions that promote good governance and effective oversight.<sup>17</sup> There is, however, an alternative to FDI that provides more flexibility. This alternative is not completely novel nor is it unique to just one region or country in the global economy, and it revolves around a theoretical construct known as the New Economics of Migration (NEM).<sup>18</sup>

## WHAT IS DDI?

When examining the definition of DDI, one might first consider the idea of transnational networks and the theoretical components that comprise them, components such as social capital, brain gain, return migration and remittances.

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<sup>14</sup> Carkovic, Maria and Levine, Ross. Foreign Direct Investment Conference. “Does Foreign Direct Investment Promote Development?” Institute for International Development. April 2005, p. 196.

<sup>15</sup> Carkovic, p. 196.

<sup>16</sup> “Just when Africa’s Luck was changing”, New York Times, August 2, 2009.

<sup>17</sup> Lumbila, Kevin N. “What Makes FDI Work? A Panel Analysis of the Growth Effect of FDI in Africa”. Africa Region Working Paper Series No. 80. February 2005, p.6.

<sup>18</sup> Stark, Oded and David E. Bloom. “The New Economics of Labor Migration”. *The American Economic Review* 75, 1985.

The authors coin this new economic paradigm in describing new linkages between migration as a distinct labor market phenomenon and other labor market and non-labor market phenomena.



DDI is a part of a larger transnational superstructure contributing to the integration of societies into the global economy via an interconnectedness of donations, small and large investments, trade, tourism and unilateral transfers.<sup>19</sup>

Transnational networks are the result of globalization and suggest that nation-states are becoming less influential in influencing international trade. Non-state actors such as NGOs, indigenous peoples, immigrants and refugees are increasingly emerging as subjects of international law. A density of political and civil cultures in large cities localizes global civil society in people's lives and multiple localizations of civil society become global in that they are a part of global circuits and trans-boundary networks.<sup>20</sup>

Any social capital inherent and crucial at the transnational level may also be defined as the "networks and the norms of reciprocity and trustworthiness" that exist among persons in a society and can be distinguished from physical capital.<sup>21</sup> Social capital (networks and contacts) combines with human capital (knowledge), forming durable social relations that fill "transnational social spaces".<sup>22</sup> In this instance, social capital can exist beyond one society and among several and binds persons including migrant workers who transmit their own social links. For example, when rural migrants move to large cities where knowledge-based development and local resources are higher than in the sparsely-populated and under-skilled countryside, a network is formed between the regions. This network facilitates a return loop of sorts to the countryside. The same concept applies between developed societies and those still developing. In both cases, migrants are driven by personal economic incentives, proximity and sentimental feelings when they wish to return to the home country (or region).<sup>23</sup>

Diasporas are merely a "sociopolitical formation" created as a result of either voluntary or forced migration. Diaspora members regard themselves as being of the same ethno-national origin and often permanently reside as minorities in one or several host countries. Workers must live in a host society to participate in any transnational enterprise. Diaspora communities then are social fields or in other words networks that link together the country of origin and the country of sentiment.<sup>24</sup> As a precursor to any more elaborate business ventures, transnational migrant workers also often remit funds to family and friends from the host to the home states. Remittances are simply forms of money flows from migrants to their homeland.<sup>25</sup> Social capital is a necessary prerequisite because trust and social networks must exist for the funds to arrive safely.

Finally, a necessary *and* sufficient part of DDI is the circular or return migration that a person undertakes to bring these skills back to the home society typically using a "set of arrangements or a well-defined interval".<sup>26</sup> A growing proportion of migration is circular (migrants return to their sending country, once or many times over a period of time) and "transnational" migration occurs when migrant communities in one or more receiving countries maintain

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<sup>19</sup> Orozco, Manuel and Lapointe, Michelle. "Mexican hometown associations and development". *Journal of International Affairs* 57, 2004.

<sup>20</sup> Sassen, Saskia. 2002, p. 217.

<sup>21</sup> Putnam, Robert. D. 2000, p. 288- 290.

<sup>22</sup> Ibid, p. 6.

<sup>23</sup> Ibid, p. 22.

<sup>24</sup> Laurence, J. C. Ma and C. Cartier. *The Chinese Diaspora: Space, Place, Mobility and Identity*. Lanham, Md: Rowman and Littlefield, 2003.

<sup>25</sup> Lowell, B. Lindsay and Gerova, Stefka. 2004, p 14.

<sup>26</sup> Tilly, C. 1976, p. 9

strong social, business, and political ties to the sending country.<sup>27</sup> These return workers provide brain gain (also called brain circulation or skill circulation), that is, they bring back skills and intellectual expertise they have acquired<sup>28</sup> and are a prerequisite in the DDI chain.

DDI can be further distinguished from FDI by the notions of social embeddedness and an intensity of community affect inherent in returning migrants.<sup>29</sup> Returning migrants not only have the financial incentives of a typical foreign investor but have the social aspects and knowledge of the local business environment and investment possibilities as well as an ethnic advantage.<sup>30</sup>

## DDI ROLES

### The Brain Gainer

The most obvious negative ramification in the DDI model for developing societies lies in its initial stage. Brain-drain, a substantial problem in many poor countries, occurs with the initial outmigration of workers especially those with skill and education. Not only is the stock of human capital depleted but other costs accumulate as well. In many developing countries, education is heavily subsidized by the state and these governments receive no returns on their investment when educated workers emigrate. The loss of skilled citizens to foreign labor markets imposes a double penalty on developing countries since the cost of educating skilled migrants quickly becomes a subsidy of sorts to already rich countries. This is compounded by the pure loss of talent and potential contributions to the domestic economy.<sup>31</sup> Furthermore, developing nations are unable to benefit from the tax revenues that could be accrued from these highly trained (and consequently better paid and more highly taxed) workers.<sup>32</sup>

This threat is especially severe in Africa, where numbers of the most highly educated leave the continent. For example, about 30 percent of all highly educated Ghanaians and Sierra Leoneans live abroad. Sub-Saharan African countries such as Zambia, Liberia, or Zimbabwe in fact represent an extreme. For particular countries in crisis, the brain drain is only one manifestation of a more general problem of an economy in free-fall. Many other countries that are seeing high levels of skilled immigration are beginning to think in terms of labor and even skills export as a comparative advantage, and to think of ways to maximize benefits. To make matters worse, most African Diasporans send few of their earnings back to their home countries. Africa receives fewer remittances per capita, which partially mitigate the loss to human capital, than any other region in the world.<sup>33</sup> According to a World Bank report, Africa received

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<sup>27</sup> O'Neil, K., 2003

<sup>28</sup> Stark, O., C. Helmenstein and A. Prskawetz, 1997.

<sup>29</sup> Nielsen, Tjai M. and Liesl Riddle. "Why diasporas invest in the Homeland: A conceptual model of motivation. Paper presented at the Annual Academy of Management Meeting. 2007.

<sup>30</sup> Ibid. p 10. Diaspora members possess an ethnic advantage in that they have a better grasp of the business environment as compared to others because of their relative knowledge and social capital advantages in the homeland versus non-diaspora members.

<sup>31</sup> Hamilton, Kimberly. *Migration and Development: Blind Faith and Hard-to-Find Facts*. Migration Policy Institute. November 1, 2003.

<sup>32</sup> Ibid.

<sup>33</sup> Newland, Kathleen. *Beyond Remittances: The Role of Diaspora in Poverty Reduction in their Countries of Origin*. Migration Policy Institute, 2004.

some \$12 billion in officially recorded workers' remittances in 2002, about 15 percent of global remittance flows to developing counts in 2002. Sub-Saharan Africa received only \$4 billion, or 5 percent of all remittances that year.<sup>34</sup>

Yet there is evidence that emigration is not invariably negative. In many countries, talented and highly educated émigrés have returned to their home countries to tap into promising opportunities there. As these professionals return to their countries, they bring knowledge and technology as well as capital and access to advanced markets in developed countries. Furthermore, they can serve as advisors and role models to domestic businessmen and even advise government officials on effective oversight and regulatory issues.<sup>35</sup>

## The Altruistic Technologist

Another major benefit of DDI is technology transfer. Diasporas are major conduits of technology and business know-how to their home countries.<sup>36</sup> As discussed above, in theory most foreign direct investment results in some form of knowledge spillover in the host country. Whether it is a vertical spillover, by which foreign entrepreneurs disseminate better business practices and technology to suppliers and distributors or a horizontal spillover by which domestic employees leave the foreign enterprise and use the knowledge they gathered there to become entrepreneurs themselves, FDI brings new techniques from the developed to the developing world, making their economies more efficient and productive.

Like FDI, DDI creates these same complementarities but its benefit will be greater than traditional FDI. Evidence shows that foreign investors try to limit these naturally occurring spillovers. Some foreign entrepreneurs are often unwilling to share their technology or institutional know-how with local workers, understanding that these workers can take this knowledge elsewhere and become potential competitors. One study showed a fear of technology leakage especially in countries with a limited rule of law. Such an instance may induce multinationals with the most sophisticated technologies to shy away from shared ownership and instead choose to invest only in wholly owned subsidiaries that are least beneficial for developing countries.<sup>37</sup> Foreign investors inhibit vertical spillovers as well. Evidence shows that non-resident investors acquiring local firms in developing countries tend to reduce the number of their local suppliers, oftentimes because they are more comfortable importing supplies than dealing with domestic businesses.<sup>38</sup>

Anecdotal evidence shows that these spillover restrictions occur less frequently with diaspora investment. The Taiwanese and Indian governments have attracted skilled members of their Diaspora to return and this has resulted in the development of highly competitive, sophisticated industries in both countries. These two examples suggest DDI is preferable to FDI in that diaspora investors are not singularly moved by the profit motive. Whereas some firms will adopt a business model aspiring to maximum profits (undercutting competitors by barring knowledge transfer), diasporas may have other motives.

In addition to profits, diasporas are prompted by altruism and a general goodwill to invest in their home countries. Thus, they are less concerned about horizontal spillovers resulting from their workers acquiring knowledge. In addi-

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<sup>34</sup> *Migrant Labor Remittances in Africa: Reducing Obstacles to Developmental Contributions*. Africa Region Working Paper Series No.64, November 2003.

<sup>35</sup> Newland.

<sup>36</sup> V.N Balasubramanyam and Yingqi Wei. *Diaspora and Development*. Lancaster University Management.

<sup>37</sup> Javorcik, Beata Smarzynska and Spatareanu, Mariana. *Disentangling FDI Spillover Effects: What Do Firm Perceptions Tell Us*. "Does Foreign Direct Investment Promote Development?" Institute for International Development. April 2005, p. 66.

<sup>38</sup> Javorcik, Beata Smarzynska and Spatareanu, Mariana, p. 67.

tion, diaspora entrepreneurs are less likely to replace their local suppliers. Because of their knowledge and experience of working in their home country, they are more willing and better prepared to work in the domestic business environment.<sup>39</sup>

Beyond enabling knowledge spillovers, DDI is also more superior to FDI because diaspora groups are better informed about the capabilities and technology necessary for working in their home country. Due to the diasporas cultural and socio-economic linkage with their home countries, their importation of technologies will be in tune with local realities and cultural sensitivities. Thus, they are more likely to import and implement appropriate technologies than foreign investors who have little experience doing business in Africa.

## The Brave Capital Investor

Another benefit of diaspora investors is that they are less averse to political risk and economic shocks than other foreign investors, often feeling a sense of pride and duty to the homeland.<sup>40</sup> Because of this bond, homeland investment is more likely to attract investment from diasporas than non-diasporas. Palestinian, Armenian, Cuban and Iranian Diaspora interest in homeland investment is driven by a perceived ethnic advantage and this makes these brave investors more likely to engage in DDI, given known risks. Altruism and a sense of cultural connectedness are also significant factors in such decisions.<sup>41</sup> Palestinian Diaspora interest in that region, for instance, made investments relatively strong even in the wake of the political instability and violence following the Intifada in 1997.<sup>42</sup>

Once capital flows arrive in the country, DDI is more likely to stay than other types of investment. Like FDI, DDI is more fixed and more difficult to pull out of the country than portfolio investment in the event of a political or financial crisis. DDI is superior to other forms of FDI because diasporas have a better grasp and understanding of the local business environment. They are better informed and equipped to manage uncertainties in their home country and, consequently, able to absorb political risk and economic shocks. Although there is little formal study of this conclusion, a great deal of anecdotal evidence does exist. Diaspora investors' willingness to invest and develop world-class industries in Taiwan and China, in spite of questionable fundamentals and serious business impediments, provides striking evidence of this fact in support of their superior abilities in coping with the shocks.

## The Catalyst

Many scholars have noted a catalytic effect of DDI on FDI. In China and Israel, diaspora investors and entrepreneurs played a critical role in attracting non-resident FDI by setting up joint ventures and promoting export for domestic companies.<sup>43</sup> Applying these lessons to transition economies, the diaspora could accelerate closing the gap that inevitably exists between the post-socialist economy and the rest of the world and provide a strong backing for integration of the home country into the global market. This is especially true if diasporan investors are "first movers." Diaspora businessmen and professionals face a lower risk of becoming the first movers. They benefit from a specific

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<sup>39</sup> Balasubramanyam, V.N. and Yingqi Wei. "Diaspora and Development". *The World Economy* 29, 2006.

<sup>40</sup> Nielsen and Riddle, p. 12-13.

<sup>41</sup> Gillespie, Kate, Liesl Riddle, and David Sturges. "Diaspora interest in homeland investment".. *Journal of International Business Studies*, September 22, 1999

<sup>42</sup> Gillespie, Kate, Edward Sayre and Liesl Riddle. "Palestinian interest in homeland investment." *The Middle East Journal*, Spring 2001.

<sup>43</sup> Freinkman, Lev M. "Role of the Diasporas in Transition Economies: Lessons from Armenia." Washington, D.C.: Armenian International Policy Research Group, 2002.

informational advantage: common cultural background and established social links between diaspora and local entrepreneurs help them to reduce transaction costs of new entry and building new partnerships.

DDI also promotes capital recycling in the developing country. Unlike other FDI, where the majority of profits of which eventually flow out of the country, a large percentage of DDI stays in the developing country with the level of non-permanent migration increasing markedly over the last decade.<sup>44</sup> Many diaspora investors return to their home countries to settle and establish a base. After their initial success, anecdotal evidence suggests that they tend to venture into other sectors of the economy, moving into upstream or downstream industries.<sup>45</sup>

## The Diplomat

Beyond promoting economic development in African countries, DDI works in the interest of U.S. commercial policy and diplomacy. First, it expands market-driven economies amenable to U.S. economic interests. DDI encourages development of internal market reforms because highly-skilled diaspora entrepreneurs provide a window to the global economy.<sup>46</sup> To succeed in this globalized setting, local businesses are compelled to adopt free market practices and they learn this from the returned diaspora. Successful entrepreneurs who are foreign-born often become important investors in their home countries because they bring back both financial resources and an infusion of entrepreneurial spirit and skills that their home countries often sorely lack.<sup>47</sup>

This process of market reform also works from the top-down with diasporan investment in the country of origin becoming a push factor for market reforms and stronger institutions. For example, the government of India has begun to institute reforms as a result of surveys of non-resident Indians and persons of Indian origin. A key finding was that their reluctance to invest in India or even to give philanthropically was due to the bureaucratic red tape and the high incidence of corruption. Such reforms in turn make the country of origin more attractive to (non-diaspora) international investors as well.<sup>48</sup>

DDI can also be a powerful vehicle for commercial diplomacy. Commercial diplomacy in the form of sustaining and supplementing positive linkages between Western developed economies and the global economic system, provides a powerful foundation for many foreign policy and national security goals. Having U.S. citizens working and investing in a mutually beneficial fashion in Africa will create a reserve of goodwill for the U.S.. This will do a great deal to advance American interests and it will do so at little to no cost. Rather than spending money on developmental aid and other forms of foreign assistance, DDI will generate actual revenues for the U.S. and the host country, creating benefits and economic growth for all parties.

## EXAMPLES OF DDI SUCCESS

Diaspora networks and their components operate unevenly across regions of the world and the global economy. The expansion of networks and the transfer of knowledge influence the outcomes of diaspora-driven economic de-

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<sup>44</sup> Graeme, Hugo. "Circular Migration: Keeping Development Rolling?" Migration Policy Institute. June 1, 2003.

<sup>45</sup> Balasubramanyam, V.N. and Yingqi Wei.

<sup>46</sup> Ibid.

<sup>47</sup> Naim, Moises. "The Diaspora That Fuels Development," *Financial Times*, June 10, 2002..

<sup>48</sup> Newland, Kathleen. *Beyond Remittances: The Role of Diaspora in Poverty Reduction in their Countries of Origin*. Migration Policy Institute, July 2004.

velopment within and across regions.<sup>49</sup> Networks are different due to unique histories, sizes and types of migration that have occurred. Within the diaspora themselves, endogenous factors like education and culture operate while other more exogenous variables also act on the home societies that ultimately affect development potential. The following section addresses several regional examples of DDI development success of varying degrees.

### **Ireland as a Celtic Tiger**

Ireland experienced a higher proportion of emigration and concomitant depopulation during the nineteenth century than any other European country.<sup>50</sup> According to David McWilliams, about 70 million people worldwide can claim some Irish descent and a great part of Ireland's past and future economic success is related to the knowledge skills and monies of Diaspora in the homeland.<sup>51</sup> Ireland may stand to benefit even more if "soft power", that is, the networks and knowledge of descendants of the millions of Irish who left the island, is used. These people are a ready made global network of talent that can be brought home in a "post-nationalist, national project."<sup>52</sup> The decades-old Irish remittance network served as the first step in helping modernize the homeland. Even with the global economic downturn's impact on the Irish economy, the process of bringing back more Diaspora with their wealth, skills and ties to the culture, might provide the Irish economy with the resources necessary to more quickly recover and at the same time reward any Irish emigrants who do with a share in that success.

### **Asia – The Chinese versus Indian Approaches**

Asia, a region that has traditionally sent millions of migrants abroad, has several well-known examples of successful DDI. These include the People's Republic of China (PRC), India and Taiwan with the latter two showcasing great success in Bangalore (the Silicon Valley of Asia) and Hsinchu Industrial Park. These are two cases where cheap labor and low-cost production and have now transitioned Beijing and Taipei into competitive centers for of technology thanks in large part to DDI. Over time, the respective governments began to more effectively coordinate these strategies and began to tap into this pool of diaspora talent, drawing on both talent and hard currency investments to promote development at home. Additional factors that have influenced migrant returns and success in Asia include infrastructure, the business climate and prevailing political and legal rights.<sup>53</sup>

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<sup>49</sup> Lowell, B. Lindsay and Stefka Gerova. 2004, p 30.

<sup>50</sup> Kevin, Kenny. "Diaspora and Comparison: The Global Irish as a Case Study," *The Journal of American History* June 2003. <http://historycooperative.press.uiuc.edu/cgi-bin/justtop.cgi?act=justtop&url=http://www.historycooperative.org/journals/jah/90.1/kenny.html> (Accessed May 18, 2009)

<sup>51</sup> McWilliams, David. "Ireland's future depends on diaspora's 'soft power'", October 3rd, 2007. <http://www.independent.ie/opinion/columnists/david-mcwilliams/irelands-future-depends-on-diasporas-soft-power-1114800.html> (Accessed May 19, 2009)

<sup>52</sup> Ibid.

<sup>53</sup> Lucas, Robert E.B. International Migration Regimes and Economic Development. Report from the EGDI seminar "International Migration Regimes and Economic Development.", 2004.

## China

For centuries, China experienced a large outflow of migrants who moved overseas and by the 1990s, more than half of the PRC's foreign direct investment came from the descendants of many of these same sources.<sup>54</sup> Yet China has recently taken a distinctly underachieving approach in capturing the benefits from diaspora funds, an approach that has not exploited its full potential. Because of its authoritarian political system, Beijing has an advantage in administering more rapid and far-reaching privatization programs even going so far as breaking down large, state-owned enterprises (SOEs) while creating economic zones geared to lure private investment and development. China's government can more effectively target certain projects using its monopoly on political and economic power across administrative boundaries while its comparable potential rival, India, has the obstacles of an often, chaotic and contentious democracy that is driven by ethnic and religious cleavages".<sup>55</sup>

Huang and Khanna point out that even if the Chinese state can more easily control local investments, it might not do as efficiently as indicated by frequent misallocation of investment funds into state projects. The millions of dollars sent from Taiwan, Hong Kong and Macau by diaspora in the 1990s, in fact, may have discouraged Beijing from implementing any much-needed reforms.<sup>56</sup> In other words, China's model of private investment has led to a complacency of sorts, indicating its direct investment approach may be incomplete or need tweaking. The State has been slow to allow domestic sources receiving diaspora aid to invest in projects thus hampering investment potential. Past success appears to be stalling and Beijing's approach has been to micromanage the economy, creating more obstacles for local entrepreneurs. At the same time, India seems to be taking an opposite strategy and succeeding in boosting economic growth.

## India

India's approach to diaspora investment seems to reflect a desire to catch up to China and its historical advantage in receiving overseas money. Delhi can, in fact, look to Beijing's failure in better using Diaspora aid and make adjustments even with its aforementioned bureaucratic and political handicaps. In fact, India's democratic, rule-of-law-based, "ground up" investment model will likely catch and surpass China's authoritarian "bottom-down" approach in the long term.<sup>57</sup> This is particularly true since Indian Diaspora utilize intellectual capital and knowledge-based industries, creating more value-added application. India's well-educated returning workers will be key in making up for the raw numbers of overseas Chinese and the head start they have had in contributing to China's rapid economic growth.<sup>58</sup>

The "Bangalore Boom" emerged because of an oft-criticized vibrant civil society, having been orchestrated by non-governmental players, namely professional associations and individual entrepreneurs. The Indus Entrepreneur (TiE) and the Silicon Valley Professionals Association (SIPA) provided opportunities for networking and information sharing as well as role models and sources of finance for entrepreneurs. However this community remains local rather

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<sup>54</sup> Yasheng Huang and Tarun Khanna. "Can India Overtake China?" *Foreign Policy*, July-August 2003.

<sup>55</sup> Ibid, p. 79.

<sup>56</sup> Ibid, p. 80.

<sup>57</sup> Marth Lagace. "It's India above China in New World Order", Harvard Business School Working Knowledge Report., July 28, 2003.

<sup>58</sup> Ibid, p. 80.

than a transnational one. Even the Indian government is responding faster than anyone predicted. Then Prime Minister Vajpayee's claim that IT stands for "India's Tomorrow" reflects the commitment to change is seen in the formation of an IT Ministry and a Cabinet committee on information technology. Meanwhile, the Securities and Exchange Board has been working actively to revise their treatment of venture capital.<sup>59</sup>

The government has also become more active in directly courting the diaspora. In 2003, Delhi hosted its first conference in honor of diaspora investors. Nearly 2,000 people of Indian origin (PIOs) from 63 countries including Nobel laureates, writers and business moguls, made the trip to Delhi. It was the largest gathering of overseas Indians in the country's 55-year history and it was all part of an effort by the Indian government to create a set of stakeholders to help build India's economic future.<sup>60</sup> The government also proposed permitting dual citizenship for Indians abroad in an effort to supplement the cultural bonds to non-resident Indians abroad. Although it would not permit voting rights, it did seek "to deepen the connection between India and its scattered seed."<sup>61</sup>

## Taiwan

In the last twenty years, Taiwan has come closest to formalizing an Asian Diaspora model. As a result, it has become a home to a number of globally competitive producers in manufacturing and semiconductor design. In the process however, Taiwan suffered from a serious brain drain in the second half of the twentieth century. Over 90,000 Taiwanese left for study abroad, and in some years returns were less than 10% of departures. The government went so far as to establish a database to track skilled migrants and matched them with job opportunities there.<sup>62</sup>

The National Youth Commission coordinates efforts to attract emigrants to return home, running job placement programs and information clearinghouse on employment, and an annual report on employment needs in Taiwan, that is widely distributed abroad. The government systematically invited scientists, professionals and highly skilled technicians back to Taiwan, to teach and to network with both officials and investors at home. Government-sponsored national development conferences bring many overseas Taiwanese to participate at government expense and contribute to the formation of multi-national networks oriented toward building Taiwan's business and technological advantages.

In places like the Hsinchu Industrial Park, the government constructed Western-style housing and developed industrial clusters to build a critical mass of well-educated returnees. The State upgraded neighboring schools to encourage emigrant investors and professionals to return with their families. Recruiting programs also targeted older scholars and professionals, offering them competitive salaries, excellent working conditions and financial subsidies available for such purposes as travel and business start-ups.

In short, the Taiwanese government has successfully courted the Diaspora not only as a source of investment funds but as a source of returning talent as well with heads of over half of the companies in Hsinchu returning from Silicon Valley in the U.S. in 2000.<sup>63</sup> It is these returning diaspora visitors who eventually become return migrants and

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<sup>59</sup> *The Bangalore Boom: From Brain Drain to Brain Circulation?* Revised paper prepared for Working Group on Equity, Diversity, and Information Technology, National Institute of Advanced Study, Bangalore, India, Dec. 3-4, 1999.

<sup>60</sup> Sharma, Amol. "Come home, we need you." *Far East Economic Review*, January 23, 2003.

<sup>61</sup> Ibid.

<sup>62</sup> Migration Policy Institute.

<sup>63</sup> Saxenian, Anna Lee. "Brain Drain or Brain Circulation? The Silicon Valley-Asia Connection," lecture at the Modern Asia Series, Harvard University Asia Center, September 29, 2000.



a source of human capital and technology transfer, that drive the development of home-grown knowledge-based industries.<sup>64</sup>

## Singapore

Singapore, like Taiwan and Ireland, serves as a model for small, resource-poor countries aspiring to develop and have large Diasporas abroad. It is in many ways similar to Ireland in population and endowments but one can discern differences between the two countries based a great part upon on the role of the state in fomenting indigenous enterprise development. Singapore and Ireland differ in their existing economic and political contexts in the European Union and ASEAN respectively as well as their emphases on roles of individual versus community responsibilities. Singapore has also used new-style immigration and emigration of younger, better-educated professionals and entrepreneurs.

The key to Irish success, however, depended a great part on small private-sector firms using and preserving a Gaelic heritage in creating an enthusiasm and national confidence in a new spirit of cultural enterprise.<sup>65</sup> Singapore succeeded in using return workers with overseas education. In a global economy, small countries have fewer choices in leveraging knowledge networks overseas more effectively to compete with larger economies.

## Latin America

Latin America is another region that has sent a large number of migrants abroad and like Asia, has the potential for significant economic growth through DDI. In the case of Mexico, the largest exporter of migrant workers in the region and one of the largest in the world, research on the migrant-worker decision-making suggests that returning Diaspora are prepared to invest in capital ventures in their home society. Diaspora returnees are more likely to invest in their home country if they are married, are home owning men with higher educations, and have spent more time abroad relatively speaking.<sup>66</sup> Mexican returnees have been more successful in establishing manufacturing or wholesale rather than retail or services businesses. This is due a great part to the larger influx of migra-dollar remittances into the community as more disposable income is available for general consumption by those living there but not necessarily for specific investment projects. The Mexican case serves as an example of a Diaspora network returning workers who have learned skills and earned the necessary capital for enterprise creation at home.

In the case of El Salvador, DDI has manifested itself in several different ways since migrants first arrived in the United States in the 1940s to work in the West Coast shipyards.<sup>67</sup> The first generation of Salvadoran migrants contrasts with the most recent Civil War group in the 1980s in how “embedded” their transnational social formations are in the United States versus El Salvador. The success of early return entrepreneurs is demonstrated in the founding of Gigante Express, the largest remittance transfer agency in Central America and a firm built by a migrant who returned home from the US and leveraged the necessary skills and education. He was also familiar with the local wages and economic conditions to establish a firm that operates across national borders.<sup>68</sup> A more typical example of a Salva-

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<sup>64</sup> Kathleen Newland and Erin Patrick. *Beyond Remittances: The Role of Diaspora in Poverty Reduction in their Countries of Origin*. Migration Policy Institute, July 2004

<sup>65</sup> Low, Linda. “Entrepreneurship Development in Ireland and Singapore.” *Journal of the Asia Pacific Economy* 10, 2005, p. 129.

<sup>66</sup> Massey, Douglas and Emilio Parrado. 1998. International migration and business formation in Mexico. *Social Science Quarterly* 79 1999, p. 18.

<sup>67</sup> Landolt, Patricia. “Salvadoran economic transnationalism: embedded strategies for household maintenance, immigrant incorporation, and entrepreneurial expansion”. *Global Networks: A Journal of Transnational Affairs* 1, 2001, p. 222.

<sup>68</sup> Ibid, p 230-231.

doran direct Diaspora investor, however, is the “mid-scale entrepreneurial couple that lived in Virginia thirty years” and returned home with a purchased truck to rent out and kitchen equipment to open a small restaurant. Clearly, both examples differ by the level of investment and management structure, yet both are similar in that the businesses benefited from a transnational circuit and a transnational field of vision cultivated through trips or long-term migration to the U.S., contact with kin and friends abroad and familiarity with migrant consumer patterns.

## Armenia

If Ireland is a case of DDI success to an extreme, Armenia is an example of a country that has not fulfilled its diaspora-driven potential. While the presence of a large, long-time, and relatively wealthy group of Armenian migrants in the US is well known, what is less known is how little their potential to develop their homeland has been reached especially during the late 1990s. On one hand, the large amount remitted funds sent to Armenia are in fact external transfers that reduce inequality across the country and many of those funds did go to families and pensioners.<sup>69</sup> On the other hand, any altruism expressed by remitters is often misplaced and the much of the money sent since 1991 is saved (almost 40% for purchasing a home or land) rather than being spent on investment or entrepreneurship.<sup>70</sup>

Unfortunately, Armenian money saving also contributes more to simple consumption than development of the private sector and a true model of development has not emerged. In one instance, the Armenia SME Investment Fund attempted to draw long-term investment capital from international lenders but was unable to raise the \$15 million matching funds required in Armenia.<sup>71</sup> Other scholars have argued that along with nervous investors at home, the political leadership there was skeptical of the motives of Diaspora and many post-communist bureaucrats hesitated to change the economic status quo or saw the Diaspora as competition.<sup>72</sup> The Armenian government and local business elites need to take advantage of the remitted funds by providing resources for better education and training to offset the “brain drain,” however temporary it might be.<sup>73</sup>

## Africa

African potential for DDI certainly exists even if any regional cases of success are not as pronounced as in other regions of the world. This potential is reflected in a survey of Zimbabwean Diaspora living in South Africa and the United Kingdom. 77% of respondents stated that they wanted to contribute to the development of the homeland and nearly half of respondents (47%) who stated they were not interested said it was due to the political leadership at home.”<sup>74</sup>

Men were more likely to want to invest in business than women (63% vs. 47%, respectively), in land development (31% and 21%), skills transfers through work (41% vs. 32%) and skills transfer through training (40% vs. 31% respec-

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<sup>69</sup> Remittances in Armenia: Size, Impacts and Measures to Enhance Their Contribution to Development, USAID Report. October 1, 2004, p. 30-31.

<sup>70</sup> Ibid p. 42.

<sup>71</sup> Lowell, B. Lindsay and Gerova, Stefka. 2004, p 13.

<sup>72</sup> Freinkman, Lev. July 18, 2002.

<sup>73</sup> Lowell and Gerova, p. 35.

<sup>74</sup> Bloch, Alice. 2005. “The development potential of Zimbabweans in the Diaspora.” International Organization for Migration (IOM), IOM Research Series, No. 17, p. 81.

tively).<sup>75</sup> Women were more likely to be interested in sending non-monetary gifts than men (27% vs. 21%).<sup>76</sup> These diaspora appear more optimistic about economic conditions and their own likelihood of success in investment if not for the political regime. Zimbabwe, in fact epitomizes the brave capital investor scenario especially in light of the current situation with the Mugabe regime. Eighty percent of total diaspora respondents see “political change as crucial for return” and 80% would return if job opportunities would increase. These same respondents, however, appear to tie economic conditions to political conditions.<sup>77</sup> The Diaspora part of the equation is clearly present to make future investments and the DDI as a Diplomat approach will be an invaluable tool when future opportunities arise that better facilitate free market practices. With the 2007 Global Financial Crisis, African foreign and diaspora investment took turns for the worse. Rwanda’s efforts to build a luxury hotel in Kigali and ecolodge in Akagera collapsed due to major cutbacks in investment funds despite the fact that many thought that Africa would be spared the turmoil of the American and European financial systems.<sup>78</sup>

DDI’s impact might perhaps be generalized across Asia, Latin America and Eurasia more in the material that makes up these transnational networks than how much actually is there. These cases suggest that it is not just the quantity of migrants who contribute to a diaspora network but the quality as well. A few highly educated return migrants (i.e. those with college-training) appear to have a greater impact on economic growth in the home country than a large number of lesser-skilled or less-educated workers. The Asian DDI model is likely more successful in driving entrepreneurship because of the large number of IT workers, scientists, engineers and skilled businesspersons while Latin America has been less successful with its large number of uneducated and lesser-skilled return migrants.<sup>79</sup>

## PREREQUISITES FOR DDI TAKEOFF

To attract and facilitate DDI, a number of institutional reforms must be adopted. Most examples of foreign investment promotion in developing countries are based on encouraging investment from multinational corporations. First, there must be equal treatment for DDI and FDI. In reality, DDI, which has far more potential for economic growth and national development, is discriminated against in favor of FDI. As one McKinsey Report reads, “foreign companies get a smorgasbord of tax holidays, import duty exemptions, subsidized land and other enticements, all offered by developing countries in the belief that this is the way to attract multinationals. For every job created, the incentives may add up to tens of thousands of dollars annually – in some cases, more that \$200,000 in net present value”.<sup>80</sup>

Developing countries must do their own part as well. Once the state has established an economic environment suitable for multinationals, policymakers are obliged to provide further enticement in the form of additional financial incentives and political risk insurance.<sup>81</sup> These incentives are “costly and reduce the direct impact” of the FDI coming into the developing countries. Once again, DDI is preferable to FDI on this account as well. DDI requires a com-

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<sup>75</sup> Ibid.

<sup>76</sup> Ibid.

<sup>77</sup> Ibid, p. 79.

<sup>78</sup> “Just when Africa’s Luck was changing”, New York Times, August 2, 2009.

<sup>79</sup> Bloch, p. 27.

<sup>80</sup> Farrell, p. 1.

<sup>81</sup> Gillespie, Kate, Edward Sayre and Liesl Riddle. “Palestinian interest in homeland investment.” *The Middle East Journal*, Spring 2001.

pletely different form of support than FDI. Rather than expensive financing deals, diaspora entrepreneurs may need more brokering assistance to establish businesses even in a homeland they believe they know. The entrepreneurs' needs may be more complex particularly in the need for networking. The Diaspora need to be introduced to people with whom they can work.<sup>82</sup>

The merits of these forms of social linkages are most apparent in South Africa where the Network of Skills Abroad, an “intellectual/scientific diaspora network” created by the Institute of Research for Development and the University of Cape Town, is an effective network to facilitate the transfer and exchange of information, linking highly skilled expatriates to their home country and informing them of development needs and investment opportunities.<sup>83</sup>

Beyond providing a channel between DDI entrepreneurs and developing countries, IFIs must also press developing countries to adopt economic reforms more agreeable to investment. Even though DDI can be a powerful force for development and economic growth, the decisive factor of investment will be the return that it can bring. This truth has been born out in China which was the number one recipient of DDI after removing regulatory hurdles for investment by Taiwan.<sup>84</sup>

## CONCLUSION

DDI can be a tremendous agent for economic growth and development, a gift that is currently being overlooked. It is superior to traditional FDI in many ways. The successful examples of returning Diaspora in Ireland and the Bangalore Boom in India both reflect the real and potential impact of this form of direct investment via transnational networks. If the level of DDI is increased to African countries, it will likely promote development and encourage additional investment in the continent via its catalytic effect.

The steps that international financial institutions (IFIs) should take to encourage DDI include the following: 1) provide equal treatment to DDI and FDI 2) provide DDI investors with brokering assistance to establish businesses in their home country and 3) press developing countries to reform their economies making them more amenable to foreign investment. Direct diaspora investment can be a tool representative of world brought more closely together by transnational networks.

Remittances, circular migration and brain gain are parts of those networks that can serve a greater purpose. These parts are natural prerequisites to DDI, a resource that can serve as an improvement to traditional foreign investment. DDI does so in that it reduces uncertainty between the investor and the investment because of pre-existing social and emotional bonds. The 2008 global financial crisis provides a context in which FDI and ODA are both expected to decline. In this instance, DDI with its bravery and resilience becomes even more invaluable

The New Economics of Migration has permanently altered traditional foreign investment practices because many of today's investors have not only economic incentives for capital investment, a throwback to FDI, but they have a certain investment sentiment whether personal or nostalgic, cultural or national. It behooves development agencies and international donors at all levels to harness globalization's positive prospects instead of merely ameliorating its negative aspects. In this instance, DDI uses these “old ties” for construction and not destruction. Social networks and the diaspora ties that comprise them will survive the current global economic shocks. This being the case, governments and their donor agencies need to swim with the tide instead of fighting it.

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<sup>82</sup> Ibid.

<sup>83</sup> Brown, Mercy. *South Africa shows the value of the diaspora option.*, SviDevNet, May 22, 2003.

<sup>84</sup> Newland, *Beyond Remittances.*

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