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Benefits and costs of FDI

Why SCBA? Because it replaces considerations of financial (or commercial) profitability with the criteria of social profitability, that can be applied to public sector projects, projects that form part of industrial policy and/or receive support by the government, and foreign investment projects because of their potential multiple impact (positive and negative) on the economy as a whole.

Benefits and costs of foreign investment projects

Benefits	***Cost***
$P_w Q$ output of the project valued at fob prices.	$\sum_i a_i P_i^w + \sum_j a_j P_j^s + \sum_l a_l W_l^s$ traded (valued at cif prices) and non-traded (valued at shadow prices) inputs and labour costs valued at shadow prices (the output foregone elsewhere by employing labour in the project)
K Capital inflows.	v earnings retaining by the MNE that can be repatriated α royalties
L Positive externalities	E Negative externalities
p Dividends accruing to nationals	d dividends paid to foreigners
τ tax revenue accruing to the government.	r social rate of discount or social rate of time preference

$$\boxed{NPV_{fdi} = \left[\left(P_w Q - \sum_i a_i P_i^w - \sum_j a_j P_j^s - \sum_l h_l W_l^s + K + \sum_t L_t - \sum_p E_p + \tau + p - d - \alpha\right)(1-r)^n\right]}$$

Problems with the evaluation

Bargaining: FDI projects can be improved through bargaining over different alternatives, un-packaging of the FDI project, and uncertainty related with different crucial variables (sensitivity analysis). But bargaining power and capabilities differ from economic situations and government.

Bargaining aims at maximising public interest, namely: maximising linkages, capital inflows, re-invested profits and technology transfers, and minimising negative externalities.

Transfer pricing: Transfer pricing is the excess over arms length pricing that MNE can charge their subsidiaries for inputs, equipment, parts and technology supplied. Transfer pricing arises from the internalisation of trade within the MNE due to vertical and horizontal integration.

$$\text{Transfer pricing} = \frac{100(P_{actual} - P_{alenght})}{P_{alenght}}$$

The reasons for transfer pricing are various, but are associated with the MNE strategy and relative economic and institutional conditions: avoiding taxes on the rate of profits, avoiding restriction on capital repatriation, bargaining over dividends to local shareholders, avoiding competitive investment, etc.

Externalities: They are usually difficult to identify, let alone quantify. Better to link specific externalities with specific actions, which also involve costs (ex., training, linkages to domestic suppliers, etc). SCBA does not provide all information. Need to link SCBA and policy towards FDI and specific firms and projects.

Is SCBA useful? Provides information about required information, alternatives, and impact of external effects and elements of policy (example, taxes and trade regime). But the policy framework is fundamental in determining the adoption of projects. SCBA is useful to inform the policy framework, but decisions are not taken exclusively based on SCBA (and should not, because SCBA is an exercise on statics and approximation).