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The Role of International Concessional Financing and Foreign Direct Investments in Supporting the Developing Countries' Transition Towards Sustainable Economic Development

Master's Thesis

Technology Governance and Sustainability

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I hereby declare that I have compiled the thesis independently
and all works, important standpoints and data by other authors
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The document length is 12,430 words from the introduction to the end of the conclusion.

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ABSTRACT

Foreign Direct Investments has been one of the known sources of funding for countries in order to support Economic Growth and Development in the economy. It has been a term that is easily circulated around when it comes to monetary transactions between territories, and has evolved into different terminologies and models over the years. The essence of it remains unchanged as a financial resource towards a specific project, goal, or objective.

This thesis focuses on how international concessional financing and foreign direct investments fuel economic activities both in the public and private sectors and connecting how the global system of production is interrelated with the flow of funding between countries. The discussion includes the role and participation of the Middle-Income Countries in the Global Value Chain, alongside different detours that they could undertake in order to catch up with the forerunners by utilising foreign investments in order to go beyond the "middle-income trap" and move towards economic growth and development. Reviewing reports, articles, and publications that are relevant to the topic, and also some gathered insights from industry players in the investing ecosystem, was essential to discuss a potentially viable benchmark to determine the type of international concessional financing and foreign direct investments that are likely to be most beneficial for developing countries, and to match it with a sound economic strategy towards upgrading is discussed on the empirical part.

Keywords: Foreign Direct Investments, International Concessional Financing, Economic Growth and Development, Global Value Chain, Middle-Income Countries, Strategy, Forerunners, Funding, Middle-Income Trap, Detour, Upgrading

I. Introduction

International financing continued to evolve over the course of time. It has acquired different classifications and terminologies by determining it based on the origin of the fund, the terms, and its purpose. Foreign Investments alone is classified into two different categories; the first and known common one is Foreign Direct Investment (FDI), and the other is Foreign Indirect Investment. While Foreign Indirect Investment is about injecting money into an existing domestic company and having a non-majority stake in it (Chen, 2020), FDI is more about a direct injection of money to influence a specific business operation and can come from either private or public entity (Siddharthan and Narayanan 2020). Foreign Direct Investment (FDI) is believed to fuel economic growth in countries, may it be for a developing country or a developed one (OECD, 2024). When certain conditions are met, such as serving the purpose of the investment, and it materializes, FDI can actually cultivate sustainable development, create new jobs in the market to enhance an economy's productive capabilities, and even act as a medium to help technology transfer (ibid). A Foreign Investment, whether classified as direct or indirect, requires a flow of money between countries and currencies (ibid).

These foreign investments do not just come from private entities or multinational corporations but also from Multilateral Development Banks (MDB), such as the World Bank (CFI, 2024). It is said that the objective of this is to foster healthy economic activity in a country or region, and the purpose of these types of investments is for infrastructure development in a lot of developing countries, infrastructure such as roads to promote trade (ibid). Some MDBs like the Asian Development Bank (ADB) are recently investing in what they call "Climate Financing", for ADB as an example, it has committed to inject $ 10 billion into the Philippines between 2024 and 2029 to address the challenges of Climate Change (COP28, 2023).

On one hand, MDBs are not the only entities that finance these types of infrastructure development. Another evolution of International Financing is called International Concessional Financing (ICF). According to the World Bank (2021), concessional financing is when an entity offers financial support to low-income regions or sovereign states to help them achieve their development and advancement goals. Usually, this type of financing is sought out by developing countries when they want to make a high-impact change in the country, such as energy crisis mitigation, rolling out vaccines during a pandemic, climate change initiatives, and more.

ICF may come from different institutions such as banks, big international organisations, public offices, and other private entities. It is known to be a flexible fund that can either come in the form of a grant, loan, or equity type of investment. One example of a grant in concessional financing is International Monetary Fund's (IMF)'s Catastrophe Containment Relief Trust (CCRT), which granted debt reliefs for the borrower's repayment to the organisation, this is in order to give an ample period of time for the low-income countries to focus on pandemic responses (IMF, 2021). It is not in the form of cashing out, but an in-kind assistance of discounting the non-payment of the debts owed to the IMF (ibid).

International Financing and FDI is especially important to Middle-Income Countries (MIC) or latecomer economies to be able to catch up to the forerunners. According to Stacey Frederick (2023), there is a need for an investment policy reform, especially in MICs who are looking for entry barriers in the Global Value Chain (GVC), it should be proactive and informed while being done in an engaged manner with the investors. The criteria for this should now consider how it can help with environmental and social improvements in the country or region, and it should be more than just about money, resource sharing, and jobs (ibid).

The author wants to understand the reason why Middle-Income Countries remained in that state in spite of receiving big international financial investments from different entities in the private and public sectors, and whether it has really helped the country towards sustainable development and economic growth or if it is what Keun Lee (2024) argued about how some countries suffered on what is called liberalization trap[1] that had them stuck in a middle-income economy state. According to Keun Lee (2024), it has been possible for latecomers to catch up with economic forerunners through different detours by not following a linear approach to becoming a leader in the GVC. Lee argued that in order for latecomers to catch up, it has to do more than just integrate themselves into GVCs through receiving FDIs or financial injections from MNCs while still in the early stages of development; the first step is to be able to access

[1] Liberalization Trap is becoming stuck in the middle-income trap, and unable to advance beyond the middle-income stage to close the gap with the leading economy *(Lee, 2024)*.

the international market strategically, and then strengthen domestically owned products, and go global once more (ibid).

From the recent environmental crises, The Lancet Commission on Pollution and Health recorded losses in welfare spending that are due to environmental pollution, which was accounted for an estimated amount of US$4.6 trillion annually, and when matched by percentage to the global GDP, it is about a share of 6.2% of the global GDP that was lost because of unsustainable practices (Altenburg and Assmann, 2017). One of the reasons for this is that people who invest and are guiding the investment pool of money do not account for the environmental losses and costs based on production, consumption, and investment trends (ibid). This goes to show that there may be a need for economic transformation and a review of investing practices to balance out the losses in the earth's biosphere, especially when the focus of economic development is human well-being, which is affected by the drastic environmental consequence of climate change (ibid).

What the thesis aims to explore is how middle-income countries can catch up with the forerunners, discuss the economic impacts of relying on foreign financial resources, and the most beneficial types of financing that developing countries receive in order to push forward sustainable development growth, including how it is best utilised. The author's goal is to be able to suggest compelling funding and trade policies, potentially a benchmark for structural transformation of Middle-Income Countries' domestic economy that will benefit them towards Sustainable Development and Economic Growth, and not just benefit the interests of the funders. Recognizing that developing countries are sovereign and can make adjustments according to what will benefit their people and sustainable growth will also help shape the direction of the conclusion of this research through the following research questions.

1. What kind of impacts do the different international financial investments have on the developing country's sustainable economic growth?

2. What kind of complementarities are needed at the local institutional level (in addition to foreign investments) to support the developing country's transition towards sustainable development and economic growth?

3. What can be learned from middle-income countries in the "global south" that are able to catch up with the forerunners in the pursuit of economic development and growth with the utilization of international investments and local FDI, and policy complementarities for sustainable economic development[2]?

To understand this process, the focus of this will be to understand the flow of financial resources between economies that fuel growth and productivity in an economy, and whether a sustainable economic catch-up is possible on how financial resources are deployed in the global economy. The author will review the political-economic behaviour of developing economies, the current economic approach used, then explore the emerging strategies that are evolving in order for middle-income countries to achieve sustainable development and economic growth, and how they are interconnected through the international financing and trade strategies of a territory.

[2] *"...economic development is the process through which a community creates a material wealth and uses it to improve the well-being of its members"* (Guigale, 2014)

II. Theoretical Framework

II. 1 International Trade and The Theory of Modern Colonialism

To briefly have an overview of the international political-economic behavior of middle-income countries, we will look at the post colonial era, where there are left traces of the colonizers in the countries they have been in. Although the countries that were colonized have gained independence, the former colonies are still living under the influences left by the powers that previously occupied the nation (IEP, 2008). A number of trade agreements are in place between countries that are now focused on inclusivity, sustainability, and worker's rights, which is perceived to be good because it is more than just the usual access to market (Reinsch, 2023). However, the main ingredient in this is that people from countries with influence are the ones taking more profit from it (ibid).

Coining the term 'neo-colonialism' has been primarily associated with the first president of Ghana in 1965, Kwame Nkrumah, according to whom there's a new form of colonialism to newly independent states by powerful or high-income countries: *"The neo-colonialism of today represents imperialism[3] in its final and perhaps its most dangerous stage. The essence of neo-colonialism is that the State which is subject to it is, in theory, independent and has all the outward trappings of international sovereignty. In reality, its economic system and thus its political policy is directed from outside."* (Watts, 2009). The middle-income countries have a tendency to be more open towards the idea of attracting FDIs to work towards their development (Lee, 2022), and that the countries with a higher share of manufacturing are more internationally integrated with higher foreign value added (Lee et al., 2018).

In this modern-day colonialism, there are no more military conquests, it is not done in the known traditional sense anymore, but due to the financial capability of the foreign countries who previously did the takeover of a country or countries, they can invest money to control economic activities and access a nation's natural resources which is somehow parallel to the previous objectives of the colonial period (Faliero, 2012). Investors primarily look for stakes and assets to maximize the growth of their money, and one of the things they look for is an

[3] Imperialism: "Imperialism is a state policy, practice, or advocacy of extending power and dominion, especially by direct territorial acquisition or by gaining political and economic control of other areas." (Brittanica, 2024)

investment incentive criteria that meet those interests (Frederick, 2023). The United States alone has a number of different international financing schemes available to developing countries. There are grants that the United States Agency International Development (USAID) provides to developing countries for a number of different social or sustainable initiatives (USAID, 2024). The agency also provides international concessional loans to develop mini-grids in different rural areas in developing nations, this type of loan is mentioned to have lower interest rates than the market ones (ibid). Then there is the World Bank (WB) that lends money to governments who need financing for their government projects, WB funds come from different sources including significant contributions from high-income countries (World Bank, 2012). Because of the intensified loans given to developing and middle-income nations, the countries are now faced with the challenges of repaying the loans instead of focusing on further development, and developing countries are becoming dependent on lenders and high-income countries (Eusepi and Wagner, 2017).

Neo-colonialism is a complex phenomenon, it is a theory that suggests outward appearances which may either be true or speculated (Coslett, 2020). It can be determined based on one of the most obvious ones, which is an imbalanced relationship between two states (ibid). These external relationships can be represented in different dynamics, such as between two known sovereign states, between a state and renowned NGOs, or could also be within a country's system where traces of colonialist policies is still existing or simply a continuation of the old colonial era policies (ibid).

However, International Trade involving monetary relationships between countries is necessary and is said to create a lot of value as it has been an effective engine for global recovery and growth (Malaket, 2014.) Malaket (2014) stated that *"International Business and international trade, undertaken with care, is commercially very attractive and can be very lucrative for businesses of all sizes..."*. Most of the trade happening in the world is backed by financing mechanisms and other processes that make the activities effective (ibid). International Trade is backed greatly by financing and is an integral part of most international transactions (ibid). Moreover, if one seeks to achieve economic growth and development, dealing with a set of a complex number of processes and multiple dynamics of different agents is something that is given, including dealing with the complexity of international political dynamics in order to work toward achieving economic development (Hartmann, 2014).

II. 2 Global Value Chain, Liberalization Trap, and Economic Catch-up

Due to geographical proximity of societies and populations, people were able to develop ways, including the invention of transportation for mobility, technology, and other platforms in order to bring actors together to coordinate different transactions that humans are actually looking for (Torre and Gallaud, 2022). The Global Value Chain is the relationship between territories that are trading or producing goods and services in order to build an end product or service (Frederick, 2019). GVC mapping has been used by different agencies and economists in order to develop new potential points of measuring economic activity on a global level (ibid). The role of the players in GVC has different classifications as either forward-linkages or backward linkages based on the value that they contribute to produce a final product or service (Frederick, 2023). They are classified more in different tiers, the lead firms are considered to be the drivers of the activities that happen from participants from tiers two to four[4] (ibid). From the perspective of neo-colonialism, the lead firms are the ones from developed countries injecting money into developing countries for supply and low-cost labour requirements. This is evident in a quantitative analysis made by De Backer and Miroudot (2013), the participation of the developing countries or those that are not part of OECD are particularly lower, and the ones from OECD countries have higher data of participation in GVC as these countries have the so-called "lead firms".

The global lead firm is the known owner of the product that is being produced, and the brand that people recognize globally, which are usually headquartered in countries that are developed, it is where there is an abundance of funding (Frederick, 2019). Whereas the lower tiers, such as primary manufacturing warehouses and plants are mostly located in low to middle-income countries, a lot of these manufacturing companies are also foreign owned, the network of production and sourcing remain to be at the control of the lead firms and tier one of the GVC structure (Frederick, 2023). The lead firms also set certain conditions from their partner firms or suppliers from Middle-Income Countries (MIC) (Frederick, 2023), lead firms can also potentially put their foot down to set some sustainability standard, which has been the case in environmental upgrading approach by the lead firms in order to cater to customer's growing conscious demand where the suppliers in MIC are the ones to cover that part of

[4] See appendix 1 for a graph by Stacey Frederick (2023) to illustrate the activities from tier one firms to tier four suppliers to produce a new product

development (Di Maria, et al., 2019), otherwise, their involvement and active participation in the GVC may be jeopardized. In the light of consumer awareness, the lead firms have now set standards about these environmental upgrading[5] conditions for heightened eco-efficiency benefits alongside increased productivity, while maintaining low prices which of course, leans more benefit towards the buyer or lead firm and has put more strain towards development to developing countries (Jensen and Whitfield, 2022). This goes to show that climbing the value chain in a linear approach may be a long-haul strategy, may not be as effective, and something that needs to be reconsidered if one intends to catch up with the forerunners (Lee, 2019).

Erik Reinert (2016) pointed out the Marshall Plan from one of his books *"There is a phase of this matter which is both interesting and serious. The farmer has always produced the foodstuffs to exchange with the city dweller for other necessities of life. This division of labour is the basis of modern civilization"* , this is a long tradition that kept on going and was revived in June 1947 by U.S. Secretary of State George Marshall during his announcement about the political and economic commitment of the country after the war (Reinert, 2016). The industrialisation of a lot of the so called "Third world countries" were affected from the devastating destruction of the war, in turn, the manufacturing and connection of the economic structure between geographies and population has become imbalanced, and so George Marshall together with Herbert Hoover who was a U.S. Envoy to Germany post world war have worked together to re-industrialise the developing countries and restart civilization on its feet in order to have acceptable living conditions, and keep the population afloat to prevent the ongoing mass migration at that time due to the economic imbalance, and to renew the traditional economic structure that existed between countries for trade and development (ibid).

Developing and Middle-Income countries can strengthen their role in GVC by being open to foreign investments to support the building of infrastructure that is vital to the function of the linkage to their role to supply or produce for the lead firms but should be backed by a firm economic strategy (Malerba and Lee, 2021). A lot of economists are still suggesting that latecomers should follow the footsteps of the lead firms or high-income economy leaders in order to achieve economic growth (Keun Lee, 2024). Even though low to middle-income countries have been so open to Foreign Direct Investments, managing the flow of income from different sources has been a big challenge on how to properly utilise them in order to foster

[5] See Appendix for environmental upgrading / innovation strategies in GVC

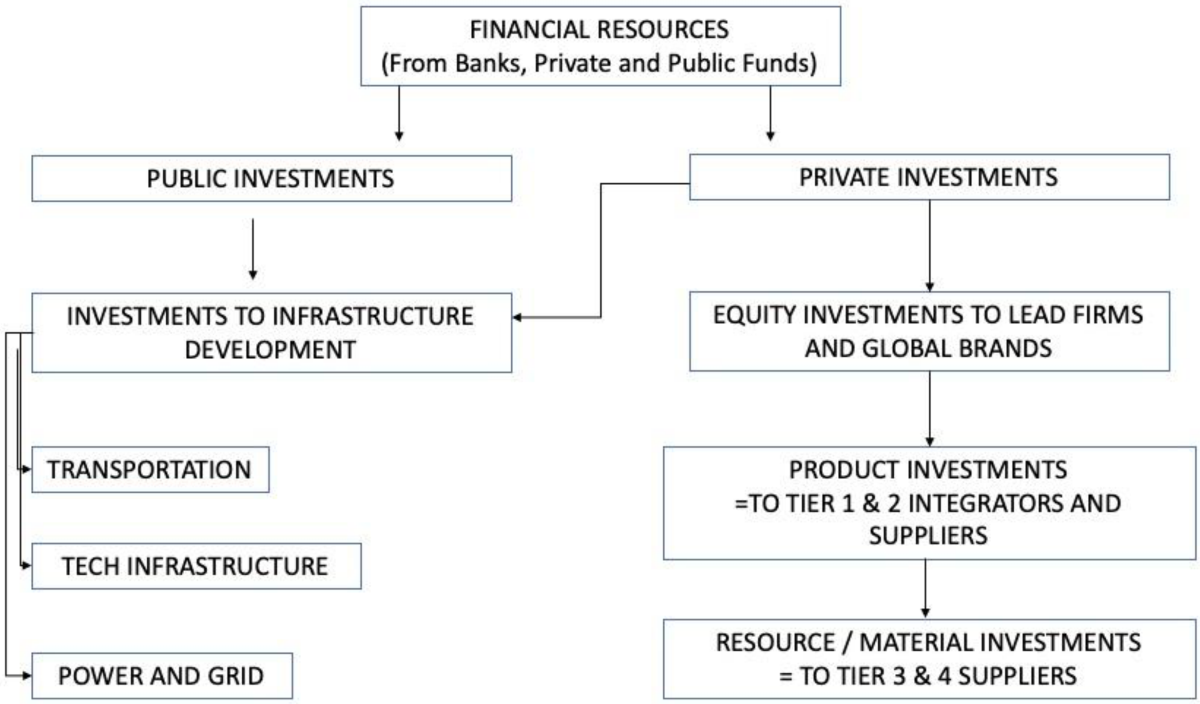
local development and growth (ibid). What ended up happening is that the known lead firms actually became more dominant in the market to drive the local economies, which Keun Lee (2024) describes as a liberalization trap.

The said worst effect of this trap is a pre-mature move towards de-industrialization and just staying in the middle-income trap in which a country is in stagnant motion and cannot move upwards in terms of growth (Lee, 2024). Frederick (2023) created a figure[6] on the participation of domestic firms in the GVC for global brands and the entry points in order to know the possibilities and the barriers of following the linear system approach in climbing up the GVC; it represents a tight entry point and a lot of indication on no opportunity for domestic firms on a global level participation. A regional and domestic GVC approach may potentially open more entry points for some opportunities that couldn't have opened up in a global brand participation on the GVC, this approach means participating in the GVC in order to learn, then focus on a local brand that could saturate the domestic or regional market, it has also been illustrated by Frederick (2023) on a figure on Domestic Firm Participation in chains for non-global brands[7], from agriculture, potential entry points could also be for processing, supplier packaging, tier one domestic firm opportunity and manufacturing services, and owning a regional brand for a target market demographic.

There is a big gap in terms of technological capabilities and infrastructure between high-income countries and middle-income countries, and so FDIs are distributed around different countries depending on the level of development (Amendolagine, et. al, 2023*).* An economic catch-up is defined by Malerba and Lee (2021) as narrowing the gap that latecomers have with the economic forerunners. Catching up has now opened more possibilities than just copying what the forerunners did but finding different trajectories that can be used to move ahead[8] (ibid). The author illustrated the flow of investments below on a private and public level based on the relationship dynamic in the GVC to potentially show how different tiers increase efficiency through investments and have a more affordable cost of production.

[6] See appendix 1 for the figure
[7] See appendix 2 on appendices
[8] See appendix 3 on how Malerba and Lee highlights the potential evolutionary process and pathways that latecomers can catch up in an illustration

Figure 1. Flow of Financial Investments in GVC



Source: Author

As per the illustration above, both private and public investments can be geared toward Infrastructure development, such as transportation, tech infrastructure, and power grids, which also feeds back into the continued relationship between lead firms and lower-tier subsidiaries. This creates a potential entry barrier for tiers one to four integrators and suppliers on the tech infrastructure, transportation, and power generation in order to level up, especially since as mentioned previously, a big gap in infrastructure capabilities of subsidiaries relates to middle-income countries receiving more financial injections in that area both as either public or private investments. As in the early stages, MICs have the capacity to now shape their infrastructure based on the latest technological advancements.

One of the possible pathways discussed in Economic catch-up is leapfrogging, and it is a form of skipping a linear approach and jumping towards a more realistic strategy, it can also be defined as something that the latecomers can try to catch up or get ahead with the economic forerunners (Malerba and Lee, 2021). In general business terms, leapfrogging is passing over the next most obvious step and moving on to the next innovation instead of going through that change that has been passed by the leaders; businesses simply leap forward to the current technological dynamics (Philippe, 2022). One example is how China was late in electronic payments with the use of credit cards, to actually moving ahead with mobile payments instead of pushing the credit card system (ibid). Leapfrogging also allows latecomers to learn from what has been done by forerunners and have low entry barriers when they decide to focus on a new innovation or technology (Malerba and Lee, 2021).

Keun Lee (2024) states that *"You cannot catch up if you keep catching up"*. And although there are a lot of financial resources directed to infrastructure development, Lee (2024) also argued that when a country reaches the middle-income stage, entering high-end sector industries also increases barriers, so latecomers would then need to attempt different detours and leapfrogging. However, leapfrogging is also not as easy, a certain strategy needs to be in place before actually taking the jump. Lee (2021) mentions a comprehensive approach to this is to first consider what a "late entry" looks like for the economy, then consider three possible detours before actually pursuing to leapfrog. The innovation-development detour was coined by Keun Lee (2024) in his recent book "Innovation Development Detours for Latecomers", he mentioned that innovation is both the bottleneck and known solution in order to go beyond the middle-income stage. There are three detours that are suggested by Lee (2024); the first one is about having a loose Intellectual Property Rights (IPR) system and leaning more on trademarks and utility models. The second detour is about having increased participation in the GVC and later reducing its reliance on it by developing a strong domestic value chain and investing resources to enter the high-end segments (ibid). Last is about focusing on short-cycle technologies first and later venturing into long-cycle technology sectors and segments such as pharmaceuticals (ibid). Long-cycle technologies need a long existing knowledge in order to be rolled out properly; hence, focusing on short-cycle ones first is the rational approach (ibid). Contrary to other economic textbooks, the promotion of free trade for economic growth and welfare is not the key to becoming rich or wealthy, but through seeking a gradual and balanced return of income that matches the countries' production capabilities (Reinert, 2016).

Another potential advantage for latecomers is that they are not locked into what is later to be considered as an old technological system, this translates to them being able to easily embrace a new one and invest in these resources (Lee, 2024). Being attractive to foreign investments does not always equate to building capacity for the lead firms, there are emerging foreign investment facilities that evolved throughout the years to help with new innovations, such as those that have a social and environmental impact. Investments to startups could be in the form of accelerators, whether local or international, that are looking for new innovations that exist or even in early stages of development that are first focused on domestic and regional markets, these accelerators have a network of small and big investment firms and high net worth individual investors (angel investors) whether they have ties with a lead firm or not (Wilson, 2024). The one uniform criterion that these private investments look for is the commitment of a business to investors on exit strategies or liquidity of their investments later on, and as long as this is clear, new tech ventures have a high chance of raising a fund (Busulwa et. al., 2020). But in order to not be sucked in by the Multinational corporations (MNCs), startups and early-stage companies also need to watch out for corporate accelerators. MNCs have adopted a system that can future-proof their business by actually opening corporate-funded incubators and accelerators, and they invest in these new innovations to have a stake in them (Suazo, 2023).

The National Innovation System (NIS) pathway that is consistent in not following a linear approach is mostly seen in East Asia (Lee, 2024). The two detours and multiple pathways highlighted by Keun Lee (2024), which was in the case of South Korea, was first about the global-local-global approach that focuses on three conditions for success: industrial policy, local ownership, and global discipline. The second detour is SMEs-Big Businesses-SMEs approach, in which they facilitate entry through resource mobilization, leading research and development, and ensuring resilience first (ibid). This approach has been effective for South Korea as the term global indicates openness to the transfer of global knowledge and foreign direct investment (FDI) but being very careful on how to not be trapped to continue the global trajectory but move to strengthen domestic ownership first (Lee, 2024). Local ownership is a vital component of this in order to direct investments to facilitate technology transfer and be able to innovate. This is what Lee (2024) argued about in an “in-out-in again” hypothesis that latecomers should do more than just integrate themselves into GVCs by being open to FDIs or accepting resource injections of MNCs, and especially being more diligent in the early stages of development to enhance domestically owned innovation capabilities and production. Redirecting the flow of investments is then important during the detachment approach or the “out” phase in order to not be trapped and re-allocate again in the last stages of development. However, comparing South Korea to other low- to middle-income countries like the Philippines may still be different. The Philippines had a long-standing relationship with America as being their past colonizer, and the U.S. was able to set roots in bringing about massive influence that brought about a behavioral colonial mindset and has remained since (Abinales, 2017).

In order to break from the dependency of developing countries on developed countries, another non-traditional economic transformation can be considered. Economic development and growth have been the focus of many governments to catch up to the forerunners or stay as a lead economic driver, and other consequences, such as environmental effects, are considered problems to be addressed later on (Altenburg and Assmann, 2017). A lot of countries are focused on economic growth and development as it is a quantifiable aspect to measure a country's progress and well-being (Karan, 2024). However, because of Global Warming, the global economy is currently in an unsustainable path. Our world has grown so much that it has done so at the expense of over-exhausting natural resources, affecting the livelihoods of many (Altenburg and Assmann, 2017). According to the United Nations Environmental Programme (2024), the way land and sea are used by the people is the primary reason for biodiversity loss. The earth's land area alone is already 75% degraded due to pollution, deforestation, or drought (Leahy, 2018). This affects the production sources of countries and how people direct investment and funding.

The ongoing environmental consequences we face are now a threat to human development and the environment (Altenburg and Assmann, 2017). If the goal for economic development and economic growth is to sustain human well-being, an economic structural change may be another angle to be looked at. More information is now available regarding the financial impact of climate change, and these risks will potentially affect many companies and countries financially (TTFCFD, 2022*)*. Between 2017-2021, the losses in natural catastrophes by climate change intensified to US$1.28 Trillion more, and the estimated risk of financial losses by 2100 is US $43 trillion as a financial risk brought about by climate change (ibid). Companies that keep on investing in technologies that are unsustainable are now at risk of writing off the major investments they made (Altenburg and Assmann, 2017).

The physical risks such as rising temperatures, rising sea levels, and other natural catastrophes can bring disruptive tendencies in production and other economic activities, the potential financial losses would be lower value of assets, lower corporate profits, market losses, and bank losses from loans and other credits (TTFCFD, 2022). The low-carbon economy transition requires a fast and wide involvement of different sectors, which includes having drastic changes in investments (ibid). Businesses have a big role to play in the sustainable transition of the economy through innovations in technology, products, services, processes and new business models (Bocken, 2023). Various forms of sustainable business models evolved over the years to meet the criteria of sustainability, wherein you also factor in nature or the biosphere ecosystem as one of the stakeholders (ibid). Since this is a demand being looked at, this is a possible innovation approach for middle-income countries to catch up.

In alignment with new sustainable innovative business models, investments in sustainable businesses also evolved, such as green and impact investing, as well as different crowdfunding schemes especially directed to businesses in developing countries from a grassroots level. The demand for investing in sustainable practices has increased in recent years, recognizing that mitigating environmental risks increases the potential for sustainable development (Stein, 2024). However, due to the lack of standardized criteria for green investments, this investment sector faces a lot of challenges, including the risk of greenwashing and spending too much resources for reporting and disclosure (ibid).

Another challenge to this is that developing countries' capacity to invest and allocate resources in green sustainability may be limited because some are still focused on meeting the basic needs of their citizens (Altenburg and Assmann, 2017). Adding to that, the unrestricted market-based allocation of resources has a low chance of heading to ideal structural change that promotes high productivity, societal inclusion, wealth distribution, and environmental sustainability. Providing accurate price signals may not be achieved by the markets, especially when investments with the potential for knowledge spillovers are not pursued due to the inability of individual investors to capture all the benefits from resulting technological advancements and market opportunities (ibid). Simply put, Altenburg and Assman (2017) emphasized that "*not a single country worldwide provides a role model for achieving decent human development sustainability within Earth's biocapacity.*" Still, the United Nations Environment Programme (UNEP) continuously promotes a path for development that recognizes that natural capital is becoming a critical economic asset and is a known provenance for public benefits where low-income individuals' livelihood depends on natural resources (UNEP, 2024). UNEP (2024), also emphasizes that the green economy is not about replacing sustainable development but creating a new focal point on the economy, including investment, capital and infrastructure, as well as employment, skills, and positive social environmental outcomes towards economic development. In Europe for example, the European Union agreed to set ESG (Environmental, Social and Governance) ratings with company participation, especially global companies operating in the region (European Commission, 2024). Yet, green transformation may still pose many challenges to catch up to forerunners and may take longer to materialize.

III. Research Methodology

This qualitative case study analysis is carried out through a review of different articles, public agency reports, publications related to the topic, and a few references to interviews conducted by the author. A case study helps in the assessment of certain existing situations in order to come up with new insights and general views from a specific situation (Raikar, 2024). A case study is used in multiple fields in order to help the researcher understand the processes and support in learning a broader perspective on the chosen topic (ibid). Through a qualitative case study analysis, the research method will help the author investigate a current challenge in the ecosystem and contribute solutions that may be effective by using existing theories and evidence (Bond University, 2024).

The author searched for a number of different available articles, reports, and publications that are relevant to the topic and reviewed different points of view from the "global south" that may relate to the subject matter, such as potential dependencies to generate enough theories and evidence before moving to analysis and conclusion. For other points of view that are not publicly available, they are sought out by the author by gathering insights from actual stakeholders who are players in the ecosystem related to the topic.

Systemic Analysis: The inter-relationship of the topic to other dependency theories, strategies, and behavioral approaches based on systemic relationships of stakeholders involved in the research is looked at. International Concessional Financing and FDI, involves cross-monetary relationships between countries, so in order to understand the topic further, reviewing the relationship dependencies in foreign direct investments is important. This includes looking at public and private investments, where it is allocated to, how it is being utlised, and what could be the main driver of the flow of financial resources between borders that affects the economic growth and development of a country.

Stakeholder Insights: In order to fill a gap in the systemic analysis, the author sought out insights from five different stakeholders with a specific role in the flow of private foreign direct investments to understand a working theory on the empirical analysis. In which the logic of selecting a resource for the insight is based on their hands-on experience in the domestic and foreign investing ecosystem. Insights were collected from the following backgrounds:

Table 1: Insight Gathering Table

WHO	DEMOGRAPHIC	BACKGROUND
Entrepreneur Seeking Funding	From a Domestic or Regional Company	Private Stakeholder from a Middle-Income Country
Government Backed Innovation Agency	Domestic Agency from a Middle-Income Country	Public Servant Stakeholder from a Middle-Income Country
Ecosystem Player with Experience in the Region	Regional Ecosystem Player	Private Stakeholder from a Middle-Income Country
Investor Seeking places to Invest	International / Global Scale	Private Stakeholder from a High Income Country
Investor and Entrepreneur seeking new market opportunities	International / Global Scale	Private Stakeholder from a High Income Country

Source: Author

The author also looked at the existing dynamics of the involved stakeholders and how one affects the other to analyse their relationships and how they impact the sustainable economic development of middle-income countries and compare them with those who surpassed that middle-income or liberalization trap.

IV. Empirical Analysis

Economic policies have been the center for structural transformation, a country has to be intentional and willing for the economy to move to the direction it intends to, one cannot create a realistic structural change without first looking at policies (Reinert et. al., 2016). The United Kingdom for example, has had a protective policy approach for about 300 years by following a traditional approach, and South Korea only did it for about 40 (ibid). South Korea's fast forward trajectory may be because of the detours it created for itself from the policies it applied towards economic growth and development. Keun Lee have greatly outlined different detour points for upgrading in the GVC, the author's contribution on this part is to layout the similarities and differences of financing and how it affects the countries' growth and development from the data collected from different sources, also, to showcase a streamlined overview from the analysis of the reading materials used by the author on how these funds can be utilised for upgrading and not get stuck in the middle-income trap is discussed below.

IV. 1 Benchmark for an Advantageous Form of Financing and Utilisation

International financing is broadly about the monetary relationships of different stakeholders at a global level; it involves the dynamics of exchange rates, trade deficits, and international investments capital flow, such as foreign investments, and how these affects international trade (Sercu, 2009). One notable example of foreign investing is concessional financing, it is when an entity offers financial support to low-income regions or sovereign states to help with their development and advancement goals (World Bank, 2021). This fund may come from different institutions such as banks, big international organisations, public offices, and other private entities. It is known to be a flexible fund that can either come in the form of a grant, loan, or equity type of investment. One example of a grant in concessional financing is International Monetary Fund's (IMF) Catastrophe Containment Relief Trust (CCRT) which granted debt reliefs for the borrower's repayment to the organisation, it gave an ample period of time for the low-income countries to focus on pandemic responses (IMF, 2021). It is not in the form of cashing out, but an in-kind assistance of discounting the non-payment of the debts owed to the IMF. The risks and disadvantages faced by countries who rely greatly on foreign debt financing is that the more debt it incurs over time due to interests, the more money they end up loaning to pay it off, and only a portion goes to fund more projects. In the Philippines, for example, the debt of the country has increased to 4% just in between the months of August to November 2022, it reached Php13.52 trillion or $246.46B (PH Bureau of Treasury, 2022). Having relied so much on Foreign Investments, the country has less and less initiatives to foster domestic or local growth of wealth to invest back into local towns or communities that may potentially generate income.

The more tightened interest rates are granted in the form of subsidised lending, the more problem it creates for central banks in the long run. It is known that central banks primarily earn from interests that they incur over time. However, the less interest it gains, especially when it averts into crisis such as the pandemic where the countries couldn't pay back anymore and is sometimes bound to by the regulations, it creates a global imbalance. According to the Trade and Development Report 2022 by United Nations Conference on Trade and Development (UNCTAD), the moves made in monetary fiscal policies in advanced economies by tightening the belt is also sending the international economy into a debt crisis, where developing countries are more vulnerable once again (UNCTAD, 2022).

In one of the press releases of World Bank (2023) on Developing Countries' public debts, it stated that the poorest countries now run the risk of facing a debt crisis due to the surge in borrowing costs. Low and middle-income countries' external debt stock rose significantly over the past decade that it surpasses economic growth, and has raised concerns about low and middle-income countries' capability to service their debt (World Bank, 2023). On one hand, according to a 2019 report by the Asian Development Bank (ADB), concessional financing has helped to reduce poverty in the Asia and the Pacific region since the introduction of it dating back to five decades ago. Without it, it would have taken more years for the developing nations to actually lessen poverty in their local jurisdictions or may have reversed back. The issue brought up by ADB is that Asia and the Pacific's trajectory related to achieving United Nations Sustainable Development Goals (UN SDGs) will not likely be successful by 2030, this is why having concessional financing, subsidised loans, and grants is its way of supporting the region to move closer towards achieving the UN SDG missions. In terms of immediate impact on societies and economies, these types of external funding, especially that of direct private investments going into private companies and startups, help create more jobs and capacity to expand their business or create new technologies (Panda, 2023) which helps boost economic activity in the region.

Equity investment in the form of concessional financing is most often done in the energy sector. The World Bank works closely with Climate Investment Funds (CIF) with their Clean Technology Fund. As an example, Kazakhstan was able to increase its energy capacity to six times more than it was (CIF, 2024). The country used it to create renewable energy technologies by launching more than a hundred projects around the country. A significant increase from 240 MW in 2015 to 1634.7 MW in 2020 was a remarkable advancement for them (ibid). From there, CIF, through their Clean Technology Fund is assumed to have convertible notes that can be turned into equity from the money they invested into the energy projects in Kazakhstan (ibid). However, the types of projects vary per country based on what is being addressed, for example in the Philippines, CIF's investment funding in the country is geared towards exhibiting the market viability of low-carbon public transport solutions while also encouraging private stakeholders to participate in industrial energy efficiency and renewable energy through a $60.51M worth of funding (CIF 2024). In Indonesia, an investment of $474M through its Clean Technology Fund and Foreign Investment Program for the purpose of advancing geothermal development in the country (ibid).

While International Concessional Financing has some different criteria in terms of purpose and Return on Investment (ROI), Direct Private Investments is a type of funding with a more straightforward approach, it is given by private entities looking for companies and startups that may have a potential for high growth return in the future. These types of investments can come in the form of convertible debt or direct equity investment (Roberts, 2022). The known entities giving these types of investments usually come from Venture Capitals, Investment Banks, Hedge Funds, Private Equity Firms, and even individual angel investors (ibid). These entities usually look for a significant return on their money over a short-term or long-term period of investment, so they take a lot of time vetting specific companies before they put their money into them (ibid). Venture Capitalists' contribution to the international flow of money is significant; in 2014, the recorded invested amount from them was $48.3 billion, and they recorded $1.3 trillion of investment returns in the U.S. alone (Rosplock, 2017).

There are two types of FDIs by MNEs in terms of connecting to the production side of the business, first is horizontal and another is vertical (Bayramoglu and Abasiz, 2018). Vertical integration is about finding the most cost-effective for the company based on the amount of goods to be produced. It's kind of creating a pyramid of transactions, and a horizontal type of integration is moving the production to countries that have the capacity but with little to no trade barriers and putting transportation of goods into consideration to ensure that it incurs minimal cost for the business (ibid). This type of FDI transaction relates to how the global value chain connects with its manufacturing and production partners. According to Bayramoglu and Abasiz (2018), exports and FDI outflows can either complement each other, or act as substitutes in terms of reflecting it to a country's economic performance.

Going back to the two types of MNE FDIs, a vertical approach affects the exports of the host country in a positive manner, they get two types of monetary transactions; first in the form of MNE FDIs and another is when the goods produced is brought back to the economy that invested to the producing country, but the other factor to this is that the investing MNE is the one affecting the significant amount of trade being produced (Bayramoglu and Abasiz, 2018). Another indirect effect of this is the amount of spillovers it can create to a country's economic activity, they can learn from the model of the MNEs, learn technologies being used, improve skills and even create new ones, because the MNEs do need to influence the production country's skill based labourers and infrastructure in order to be able to connect with their requirements (ibid). It's been a long standing mechanism that export performance of a country is connected to the FDI that a country receives, when a significant FDI is injected into a country, it translates to increasing exports and production (ibid).

As more jobs are being available, the education system is also slowly being remodelled, the skills and knowledge of society are being improved. The universities also became a central institution by being a beneficiary of different types of grants from developed countries such as the one from the European Commission (European Commission, 2024). The funds were able to give resources to academic research and new programs that may not have been possible without funding from other entities.

Other forms of international investing are Grants-In-Aid and Subsidised Lending. Grants-In-Aid is a very competitive one. There are a lot of available grant money but there are also a lot of people that seek it given that it has a broad scope; it can fund research, early solutions, experiments, infrastructure, and disaster recovery efforts, all in the form of monetary hand-out with no expected monetary return (Bauer, 2015). In relation to mentioned different forms of foreign investing, there's a notable level of similarities and a few differences depending on the type of investment a country seeks out. Concessional Finance, Grants-In-Aid, Subsidised Lending, and Direct Private Investments vary in terminology, and the fund may come from totally different entities. Still, they are all forms of monetary handouts given to regions, institutions, and countries that cannot produce a certain level of capital to support a project or mission of advancement. The author created a table below to summarize the notable similarities of the mentioned types of financing.

Table 2: Similarities and Differences of Financing

TYPE OF FINANCING	FOREIGN / EXTERNAL FINANCING	FOR SOCIETAL AND ECONOMIC AID	BOUND TO MONETARY RETURNS
Concessional Finance	Yes	Yes	Sometimes
Grants In Aid	Yes	Yes	No
Subsidized Lending	Yes	Sometimes	Yes
Direct Private Investment	Yes	Sometimes	Yes

Source: Author

From the comparison above, we can start looking at a potential benchmark of International Concessional Financing that may contribute to low to middle-income countries' sustainable development and economic growth. The most seemingly easy answer for foreign financing that would benefit a developing or middle-income country is in the form of a grant, and use it for infrastructure development and special projects as it is not subjected or bound to any monetary returns. On one hand, grants have tight expectations, and resources can only be used for a specifically pointed project and not a flexible fund that can be re-allocated to other areas of the organisation, agency, or government it was granted to; grants also now have contractual bounds based on the purpose it serves, seemingly becoming an ad-hoc service agreement with a grant giving body (S3 Solutions, 2021). This also gives a sense of free money given by a funding agency to a specific project or goal, creates dependency and is susceptible to corruption[9] as it is not bound to ay monetary returns, leading a certain project to not be self-sufficient.

The government plays a crucial role both in a country's development and management of resources, Tilman Altenburg (UNEP, 2023) said that "*Government's role is to facilitate investments in a coordinated way and to set incentives to direct structural transformation in a desirable path"*, this is true in a way that resource generation, allocation and distribution should follow a strategy towards a specific goal or objective. A flow of foreign direct investments is especially important at the initial development phase and to catch up, the participation in the global value chain has an undeniable correlation with international monetary relationships between countries, one can barely exist without the other.

International Concessional Financing in the form of debt or subsidized loan can be more beneficial if it is directed towards development of national innovation capabilities of the country in order to catch up with the forerunners as long as they don't go over the percentage of the country's GDP per capita so they don't suffer a debt crisis and be able to pay back the loan if it's granted in such form of financing. For forerunners such as the United States, in order to prevent a debt crisis, they set a ceiling of a federal debt they can incur, and they are not legally consented to go beyond that amount (Lemieux, 2013). Concessional grants are especially tricky when it is not bound to any monetary returns as there are no strict parameters that revolve around its usage and can be subjected to mishandling. In 2023, Multilateral Development Banks (MDBs) announced over $180 Billion of financial investment commitments to developing countries for a climate financing initiative (COP28, 2023). MDBs are a major source of financial resource to a lot of countries in the Global South, these MDBs have influenced how economies work towards economic development, Bazbauers and Engel (2021) would put it as *"The development banks have shaped the thinking about what development means and how to go about it"*.

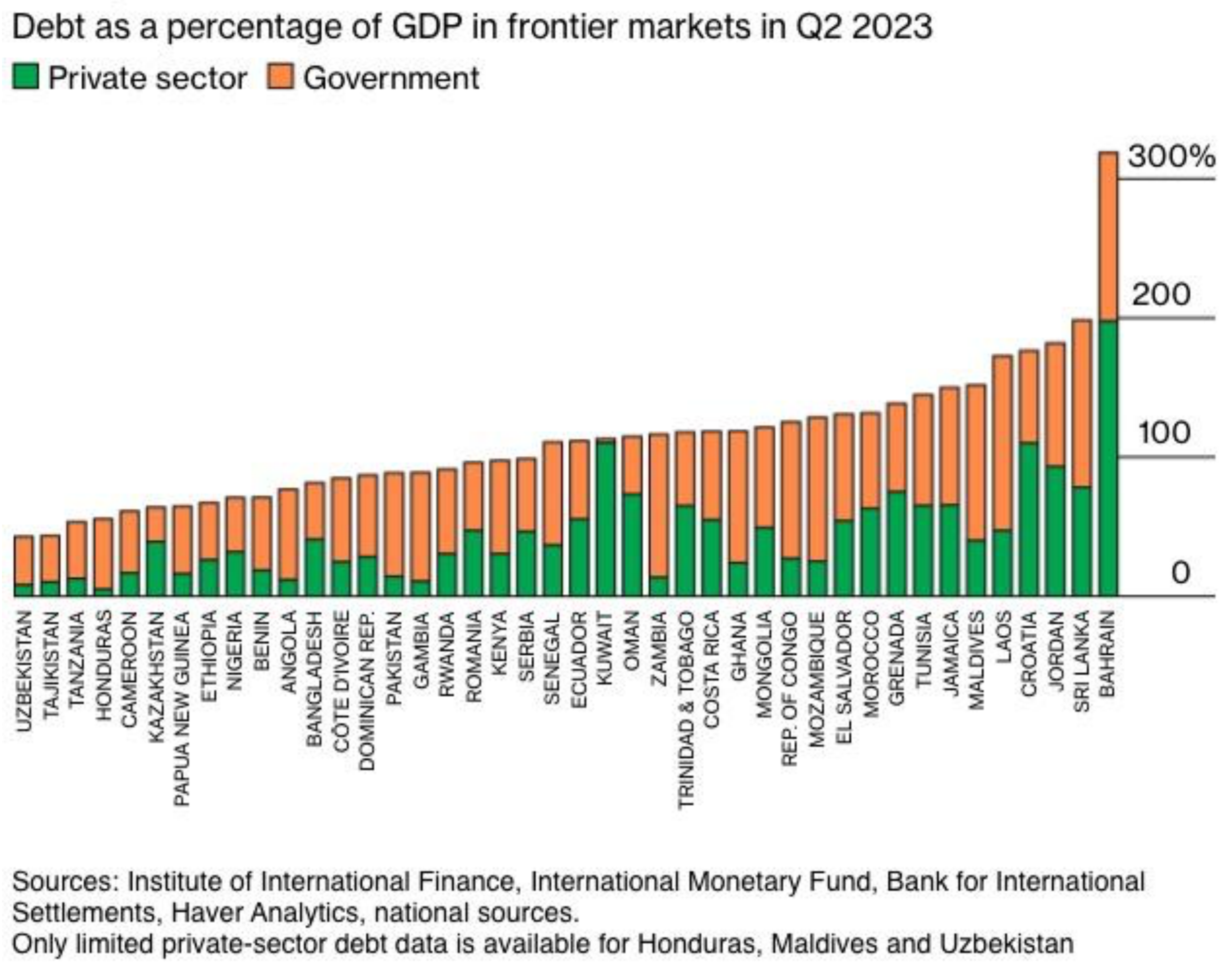
In terms of Economic structure, the three sources of growth in an economy are physical capital,[10] labour force, and technological capability, the three factors are summed up together in order to measure growth of a country (Valdes, 1999). As mentioned on the previous chapters,

[9] "It is a deviant behavior associated with particular motivation at public expense". (Freidrich, 2002)
[10] Physical capital are tangible assets such as cash, machinery, etc. that can be reused.

between 2017-2021, the losses in natural catastrophe by climate change intensified to US$1.28 Trillion more, and the estimated risk of financial losses by 2100 is US$43 Trillion as a financial risk brought about by climate change (TTFCFD, 2022), With these catastrophes happening globally, the Global Value Chain is affected by these phenomena that could lead to global economic crises and needs to be addressed. These climate investments are still geared towards infrastructure development in middle-income countries in order to assure smooth relationship and operation of suppliers and lead firms on the supply chain. This funding will be helpful for the countries but it relates back to the argument of being able to strategise on an 'in-out-in again' strategy by Lee (2024) in order to utilize these financial injections to an Innovation Development Detour.

International Finance Corporation (IFC), the agency investing through private sector in low income countries is still focused on equity investments in the countries they described as "frontier" markets or in other words developing countries, they believed that these are emerging markets that needs more support may not be quite there yet but they believe that it will still happen (Feiser and Ibukun, 2023). IFC also thinks that equity investments will work for the developing countries as it is not in debt but in exchange of ownership of assets or stake in the company, and in the case the investment doesn't work, the country doesn't owe anything (ibid). The example they give to promote private equity investments to the "frontier" countries is how the investment to South Korea's stock index in 1993 actually gained significant returns later on, when a lot thought that it was a charity case but proven otherwise (Feiser and Ibukun, 2023). Below is a graph on the share of private sector investments versus the government's for some of the listed "frontier" countries.

Figure 2. Percentage of Private Sector Investments



Source: Feiser and Ibukun, 2023

It is shown on the graph above that some countries have a higher percentage of private sector investments such that of Bahrain, Kuwait, Croatia, Kazakhstan, Oman, Grenada, Trinidad and Tobago, etc. Foreign Direct Private Investments are more straightforward in nature with a criteria in looking at numbers and market forecasting. At the same time, concessional financing have different possible criteria that are not black and white.

As discussed in the chapter on modern colonialism, the imbalance of relationships between actors may sometimes cause a turbulence in the growth of an economy, in order to foster the three things said above, an economy should find ways to balance the playing field with other actors and stakeholders. According to Guigale (2014), there’s always a chance for big economies to experience what he calls a *"...fiscal, financial or confidence crisis which could spill over to the rest of the world*". This shows how important it is to have strategic physical policies both to interact with players internationally and as well as still be able support one's domestic economy in times of crises.

Now, when we talk about possibilities of upgrading by strategically in the GVC by using the funding a country receives and how the funds can be utlised towards something that is beneficial for them, the author created a table below to explain how funds can be maximised to its potential to avoid the middle-income trap.

Table 3: Financing Avenues and Fund Potentials in GVC Participation

Requirements for GVC Participation in Production and Manufacturing	**Financing Avenues**	**Fund Potentials**
Tech / Machinery	FDI from MNEs	Level 1: Fund utilised to build manufacturing plant Level 2: Fund utilised for technology asset transfer *(global-local-global)*
Labour / Talent	FDI from MNEs	Level 1: Fund utilised to pay labour salary Level 2: Fund utilised to learn from MNEs (*in-out-in opportunity*)
Export Capability and Capacity : Roads, Transportation, Tech Infrastructure, etc.	- International Concessional Financing (ICF) through Grants or Loan - FDI from MNEs and other financing institutions	Level 1: Fund used to build roads based on traditional means Level 2: Utilised ICF for Technological Advancement based on up to date infrastructure (*leapfrogging opportunities*) Use of FDI for *technology asset transfer*
Knowledge on Product: Research and Development of tools and machineries for production efficiency	- International Concessional Financing through Grants or Loan - FDI from MNEs and other financing institutions	Level 1: Use of fund to produce required products Level 2: Utilised fund for New Business / Product Innovation from Technology Knowledge Transfer in a form of SMEs (*SMEs-Big Businesses-SME detour*)

Source: Author

The role of International Concessional Financing and FDI is crucial in the development of an economy but it has to be utilised well. Based on the table above, an economy is stuck in a middle-income trap if they just focus on the level one potential and capacity of the fund. Level two offers the most advantageous potential of these funds by using a strategic policy and objectives, and using different financing avenues can harmonise the objectives more efficiently in order to be able to upgrade and grow the economy. The next two subsections show how the level two fund potential may have been used by some middle-income countries in the global south to be able to upgrade and catch up with the forerunners, first in the form of focusing on infrastructure development funding and using that as entry pathway for technology advancement and upgrading the role in GVC, and followed by a subchapter on private business setting approach on the flow of private funding and the barriers it has to surpass in order to not be stuck the middle-income trap.

IV.1.1 Infrastructure Development and Transformation Funding to Middle-Income Countries

Tirumala and Tiwari (2023), quoted the British former Prime Minister, Margaret Thatcher when she stated *"You and I come by road or rail, but economists travel on infrastructure",* they mentioned that these phrase aligns with the notion about the vagueness of what infrastructure really means, as it could be interpreted to be different things other than just roads and transportation, but many people will agree that infrastructure is something that enables a lot of things to work for a good quality of life that may lead to economic growth. There's currently a big infrastructure gap between developed and developing countries, that is why enabling a stronger one has been the focus of some policymakers (Tirumala and Tiwari, 2023). There is a big requirement for investments in a more specialised way that matches the level of development of a country, as they are all in different stages, Asia alone would require around $1.7 trillion on infrastructure development to ease the big infrastructure gap (ibid), this is why there should be an emphasis on the importance of financing infrastructure in a bespoke way. The infrastructure projects are also being more complex due the fast changing environment of technology and effects of climate change so it is being more and more complex, MDBs and other agencies are finding more ways to have different types of financing for different levels of development (Tirumala and Tiwari, 2023).

Infrastructure development to middle-income countries towards green sustainability is becoming an interest of investment from developed countries, this helps explore how effective it will be for society and the efficiency it will bring to the Global Value Chain. An example is Costa Rica's Decarbonization Plan with a primary driving force from the United States. U.S. and Costa Rica has a long standing bilateral relationship, especially that in 2004, Costa Rica was added as another country to the Central American Free Trade Agreement (CAFTA), moving its position as part of the countries with free trade agreement with the US and the members of NAFTA (North American Free Trade Agreement) (Bondarenko, 2024). In 2018, the Department of State and U.S. Agency for International Development (USAID) committed $347 million on what they call a "bilateral, regional and humanitarian assistance for Costa Rica", they also added on a report that "*A safe, prosperous Costa Rica contributes to regional stability and leads directly to a safer, prosperous United States*" (USAID, 2023). The United States funded a wide range of infrastructure development to Costa Rica more than just the physical infrastructure aspect of it but also through knowledge transfer, they work with the Costa Rican government agencies and NGOs for the country's improvement on police professionalism, corrections system, and even mentioned to help strengthen its judicial sector, including some social welfare activities to empower vulnerable communities and age groups (ibid).

Following the funding from USAID to Costa Rica's infrastructure development on the Decarbonization Plan, other MDBs have loaned Costa Rica millions towards this plan. the Inter-American Bank (IDB) alone loaned $300 million in 2022 for Costa Rica's continued efforts towards the Decarbonization plan[11] (IDB, 2022). This move is in relation to Costa Rica's heightened participation in the Global Value Chain, assuring its infrastructure meets the capabilities for trade transactions. In 2011, OECD's *AID-FOR-TRADE: Case Story* gave Costa Rica a spotlight on the strategy of FDI Attraction and Participation in Global Value Chains where it has emphasized having a strong strategy in place to be attractive to Foreign Direct Investment (FDI). Some of the challenges they faced before 2011 were on transportation, improving its business climate, energy, and telecommunications. As for the strategy of being attractive to foreign investments including technical assistance in the form of grants and subsidized loans, they aim to use this funding to address those infrastructure challenges (OECD 2011). Costa Rica's strategy gave them a consequential transformation of their exports, leading

[11] Decarbonization Plan's goal is for the Costa Rica to have net-zero emissions by 2050 (IDB, 2022)

their economy to have a massive share and participation in the GVCs, where 43% of their exports is for its participation in GVCs (ibid). Costa Rica's strategy to pursue and increase FDIs has allowed them to diversify its export portfolio that is related to *"high-tech and advanced manufactured goods"* (ibid). Costa Rica's 2011-2014 National Development Plan highlights FDI as the main strategy towards economic growth and development in order to keep on providing employment, increase exports and diversify its portfolio while also being able to access leading technologies globally (OECD, 2011).

As per the relationship of the lead firms and the lower tier subsidiaries, it was mentioned in the previous chapter, the lead firms also set certain conditions from their partner firms or suppliers from Middle-Income Countries (MIC) (Frederick, 2023). Costa Rica's move to decarbonization plan is of interest by the forerunners in order to strengthen the value chain in the region, especially America's move towards sustainability. Costa Rica is slowly being a leader in green technology infrastructure and has gained accessibility to the leading technologies. This type of strategy in funding mechanisms can be matched with "in-out-in again" approach by Lee (2024), where they are opening up more to the global value chain and accepting the investment flow towards infrastructure development in order to attain sustainable economic development while ensuring the security of its natural resources and supply chain. Costa Rica is taking a stronger position in the Global Value Chain as not just a lead supplier and manufacturer, but also an emerging leader in green technology infrastructure. The current funding from the forerunners gives Costa Rica a symbiotic relationship with the funders in order to work towards a Sustainable Economic Growth and Development, they saw a window of opportunity on the demand for new green technologies. Their next stop is now crucial in order to surpass the financial dependency to forerunners or what is coined by high-income countries as an alliance through a modern form of colonialism in the form of financial dependency.

As Frederick (2023) mentioned, "*Coordination and collaboration among stakeholders and policies are key elements across chains and countries*", and that one common trait in a successful upgrading in a value chain is through having multiple stakeholders involved in the strategic process, and these stakeholders should primarily include government, industry, and academic participation while having a sound strategy both for entry and upgrading. Then followed by Lee's (2024) recommended approach on a development detour based on "Global-Local-Global" strategy, through the three conditions he outlined which are said to be: *"the* *enactment of public initiatives, including industrial policy, the emergence of domestic ownership, and the discipline by world markets".*

IV.1.2 FLOW OF PRIVATE FDI IN SOME DEVELOPING COUNTRIES

Many countries are focused on economic growth and development as it is a quantifiable aspect to measure a country's progress and well-being (Karan, 2024). Some countries are focused on infrastructure development through grants and public loans or debts, sometimes, the domestic capabilities and ownership has been given less priority. Foreign Direct Investments, especially private ones in the form of equity can help boost the country's GDP but it would still depend on the policies of a country for it to materialize. As mentioned in the early chapter, being attractive to foreign investments does not always equate to building capacity for the lead firms, there are emerging foreign investment facilities that evolved throughout the years to help with new innovations, including initiatives that have a social and environmental impact.

For these investments to be successful and be able to happen, fiscal return alone is not enough in terms of doing business, a support in government policies is also a factor. To further look at this, the author gathered insights from a few venture capitalists below on the challenges they face when investing in a low to middle-income country.

"Even though there is a potential high return from a private company but there is a weak investment infrastructure in the country such as incentivizing the investors tax, ease in equity ownership for foreigners and exit points, we will think twice before going for it" .

- Representative of a United States based Venture Capital (April 27, 2024)

"While a country's investment policies cannot override market fundamentals and other factors, they can definitely end up being a barrier and some regulatory policies can end up being deal breakers. Tax policy is often a primarily consideration. For example, if the country's tax system punishes capital gains with a very high tax rate, that would often

disincentivize Venture Investors, given that the primary source of return for [a] VC fund is through an exit of the portfolio company…"

- Representative of a Global Venture Capital (April 30, 2024)

Such as in the case of tech entrepreneurs and agencies in developing countries, who seek foreign investments but are faced with a challenging local entrepreneurship investment structure correlating with the flow of funds to domestic companies from foreign funding. Below are insights from people in the industry from middle-income countries in South East Asia.

"I think one of the challenges [in the Philippines] is the Ease of doing business…

We are a Philippine company serving the Filipino market but we registered an entity in Singapore [because] they have a friendlier infrastructure for taking in foreign investments for startups. We raised our Series-A through [our] Singapore entity. Investors know we are a company in the Philippines but for them to invest in us, we should be registered in a country that gives them ease of doing business."

- Representative of Philippines based Fintech Platform (April 25, 2024)

The flow of money through this goes to a higher income country first before it moves on to the base of operations in a middle-income country, which deducts some of the operating costs that a company needs to spend to maintain an entity in a high-income foreign country, leaving less flow of money going back to the home country as the case of the startup and entrepreneur mentioned above. This is not an isolated case in middle-income countries in South East Asia, a similar sentiment but in this case from a government backed agency in Malaysia supporting innovation and startups in the country is also experiencing a similar challenge, followed by an insight from a regional ecosystem player in Indonesia as quoted below.

"Malaysia is good in running incubators but for scaling in the region, it's Singapore. Grab did not get any investments from local investors, they moved to SG for the funding they

require to scale up. Hence, Grab is arguably known as a Singapore unicorn and not Malaysia. Grab did get seed funding when they [were] MyTeksi since it's a smaller fund size, after that, [a] lot of Startups in Malaysia need to raise funds from investors outside [the country]. Malaysia is seen as the incubator, but to scale up, they move out [of the country], usually to Singapore. To sum it up: Incubators and seed funding are available locally, to scale up means go to Singapore, to serve a bigger market means [go to] Indonesia."

- Representative of a government-backed agency in Malaysia (Insight gathered by the author on April 28, 2023 for an academic paper - see appendix)

"There are four challenges in investing in the country, first is regulatory uncertainty, then infrastructure limitations, intense competition for fund seekers, and talent drain. In terms of Regulatory Uncertainty, frequent changes and unclear regulations, particularly in emerging sectors like green tech, pose a significant challenge…Infrastructure limitations because of having patchy digital infrastructure, especially [in] major cities, can hinder nationwide reach of starting a business…"

- Representative of a Regional Accelerator in South East Asia (April 30, 2024)

Based on the above insights of ecosystem players, this shows the challenging dynamics that a middle-income country is facing towards sustainable economic growth and development, private foreign investors are willing to put in money but policies, investment schemes, and infrastructure in a middle-income country stops them from doing so, they look for places with a friendlier strategy to foreign investors. Leading some middle-income countries to pursue traditional pathways. In the case of Grab, they were thriving as a startup but couldn't grow further due to entry barriers for investors in their home country, so they ventured into having a headquarter in a foreign country and expanded their operations regionally. This is a good sample of the regional entry barrier that Frederick (2019) explained, starting from domestic ownership and instead of going global, pursuing an entry point to a regional market. For several years now, Grab has led the ride sharing infrastructure in South East Asia, in their early days of operations, they even provided smartphones to drivers in order to have a smooth operation of their mobile platform. Through their strategy, grab was able to saturate the market in South East Asia compared to other global ride sharing apps because they focused on the localized dynamics. This is an example of a successful entry point in the GVC by focusing on new technologies and a regional entry point using a global approach. It could have been a great success for Malaysia towards a step in surpassing a middle-income barrier if they had a friendlier investment infrastructure in place during that time. However, the flow of money in Grab's investments has been heavily put on a higher-income country than their home country because of how Singapore as a leading economy in South East Asia developed a friendlier infrastructure for investments and regional entrepreneurship where potential regional lead firms can have an ease of doing business.

Even when countries have domestic initiatives for development of local companies and firms, the flow of foreign resources needs to be addressed in a smart and strategic manner. If there is limited flow of resources in a developing country, a way to attract foreign investment should be backed with trade and fiscal policies that align with it. Prevention of mishandling of foreign funds and having checks and balances in place is important to prevent a country from experiencing one of the foreign investment crises, such as corruption tendencies. No matter how much investments are injected to a middle-income country but there's no aligned system that binds the co-relationship of the flow of funds, catching up to the forerunners will still be very challenging. Especially when the forerunners are the ones who have a more incentivized investment and entrepreneurship approach because they can afford to do so. Singapore is a very small country in South East Asia but its strategy to be a regional lead country to provide friendlier infrastructure for both domestic and foreign investments and entrepreneurs made them surpass the middle-income trap. Singapore has been one of the countries in South East Asia that are able to attract foreign startups and venture capital because of its reasonable regulatory environment (Pangarkar and Vandenberg, 2022). There is evidence that venture capital firms in Singapore have encouraged startups from the South-East Asia region to register in Singapore because of the startup-friendly environment (ibid.).

Lee's (2024) Detour 2 on "SMEs-Big Businesses-SMEs" could be used by the middle-income countries in South East Asia in order to catch up with the forerunners with their use of funding. This may be a theory in the case of Singapore, as although having started with empowering small businesses, they now have big businesses and are now returning to the grassroots of investing to local entrepreneurs. According to the Singapore Venture Capital and Private Equity Association, venture capital investment in Singapore-based companies more than tripled from $1.34 billion in 2014 to $4.92 billion in 2018 (Singapore Business Review, 2019). The reason behind this growth is the government-founded Technology Incubation Scheme (TIS) that operated from 2008 until 2016 (Pangarkar and Vandenberg, 2022). The main idea of the scheme was that Singapore's government co-invested up to $500,000 into individual Singapore-based startups, and over time this scheme attracted both venture capitalists and high-quality startups and also provided the governments with a template for improved policies to investing in startups (ibid.).

The focus on private capital is an important factor that should not be overlooked. This is why Private Foreign Investment is an angle for policies that could very well be of help for economic development and growth. Private and public investments are very much intertwined with one another in order to boost productivity (Tirumala and Tiwari, 2023). When there is an injection of private capital into businesses, it increases employment and competitiveness of wages and productivity, this translates to collection of taxes, as well as a positive effect on borrowing interests to be lower (ibid). Vice versa with a public capital, it can move productivity of the private sector to a higher level (ibid).

V. Conclusion

The effective use of Foreign Investments towards Sustainable Economic Growth and Development is highly dependent on government intervention, matched with a sound strategy that is aligned to the objectives of the country. There is an abundant available source of funding across different channels, from High-Income Government Funds, to MDBs, to NGOs, and Private Investment Agencies that are directed to specific purposes and goals. The foreign and external funding ecosystem indeed helps with certain objectives of low to middle-income countries and regions, and if done well, it can contribute to a country's long-term goal to catch up with the forerunners to achieve sustainable economic development and growth. These types of funding are definitely helpful in times of crisis such as the pandemic, or natural catastrophes, and developing a country's infrastructure. However, if taken into account all the factors that go with it, these funding schemes would seem to have more long term disadvantages to developing nations and is more likely to fall into the middle-income trap, if fund is not utilized well towards achieving sustainable economic growth and development.

No matter how much financing a country receives but it is not strategically used towards a strong set of goals and objectives for economic growth and development, a country will continue to be financially dependent on external financing bodies. Surpassing financial dependency of the developing countries to funding organisations is a goal that needs to be outlined by middle-income countries and how to increase its GDP with the use of foreign funding injected to its economy through an innovation system approach and potential detours. If put in a business setting terminology, the government should have an exit strategy for the financing they receive that will benefit their country more than it benefits the funders.

A bespoke strategy based on the capacity and capabilities of the country should be prioritised. The policies on International Concessional Financing and Foreign Direct Investments should not just focus on public sector financing, an emphasis on both the inter-relationship of public and private stakeholders is important as the flow of investments in the Global Value Chain involves stakeholders from both sides in terms of aligning policies, innovation initiatives, and boosting productivity.

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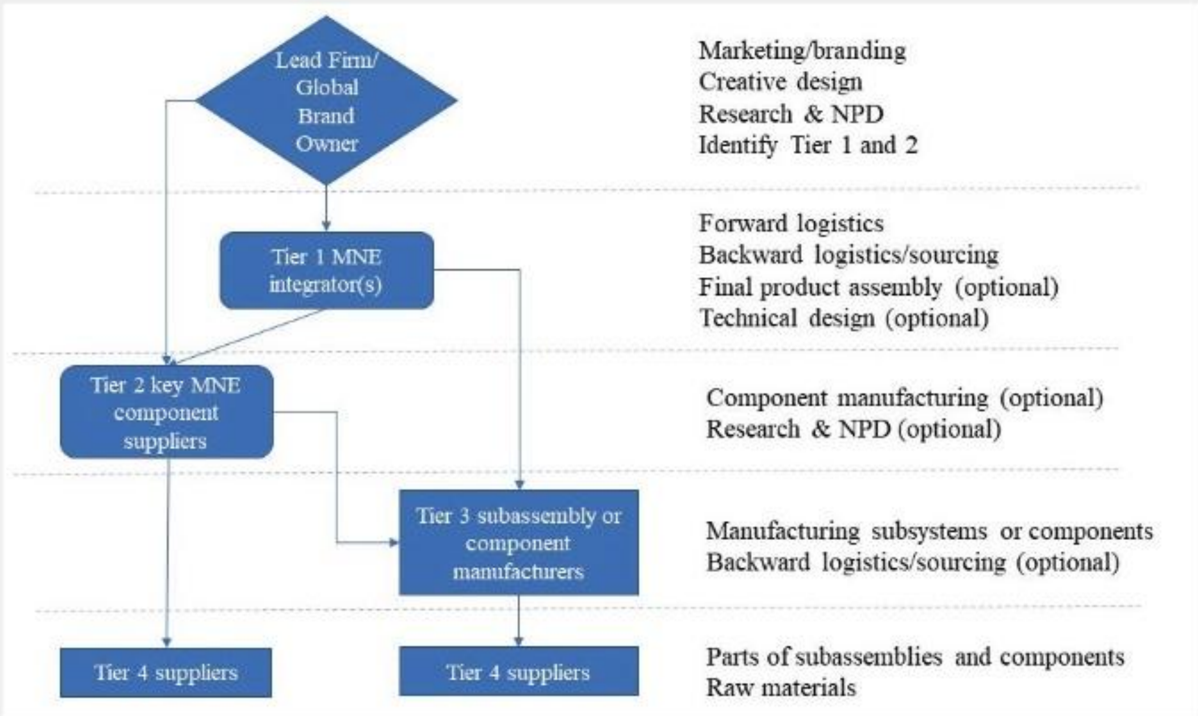
Appendices

Appendix 1: Manufacturing GVC tiers and Activities

Figure 1. Manufacturing GVC tiers and activities

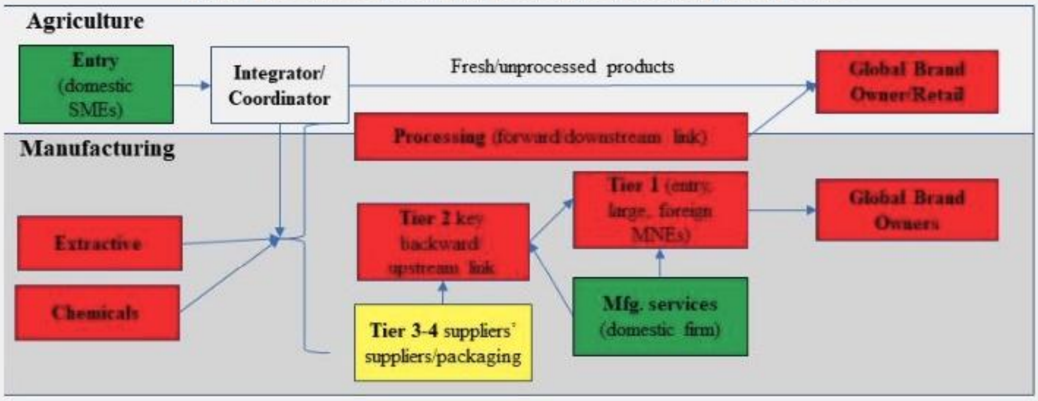


Source: Author; new product development (NPD)

Source: Stacey Frederick, 2023

Appendix 2: Entry Points of Domestic Firms for Global Participation

Figure 2. Domestic firm participation in chains for global brands

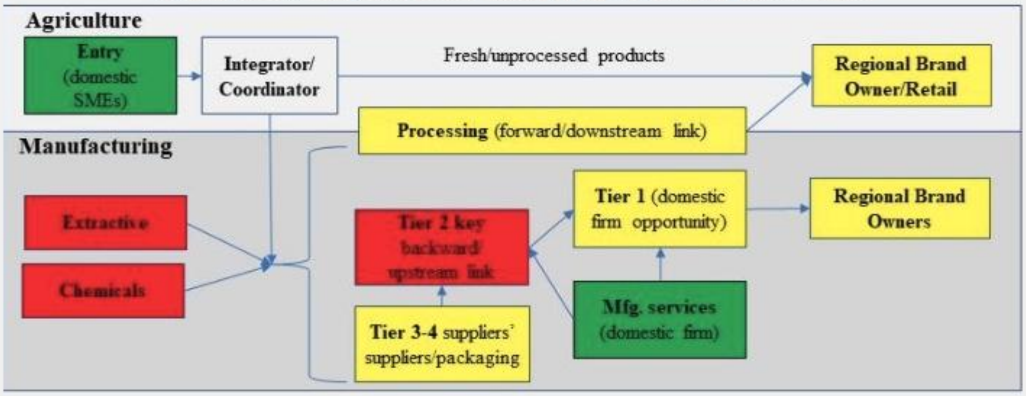


Source: Author; red indicates little no opportunity for domestic firms; yellow represents some opportunity; green indicates primary opportunities.

Source: Stacey Frederick, 2023

Appendix 3: Entry Points of Domestic Firms for Local/Regional Participation

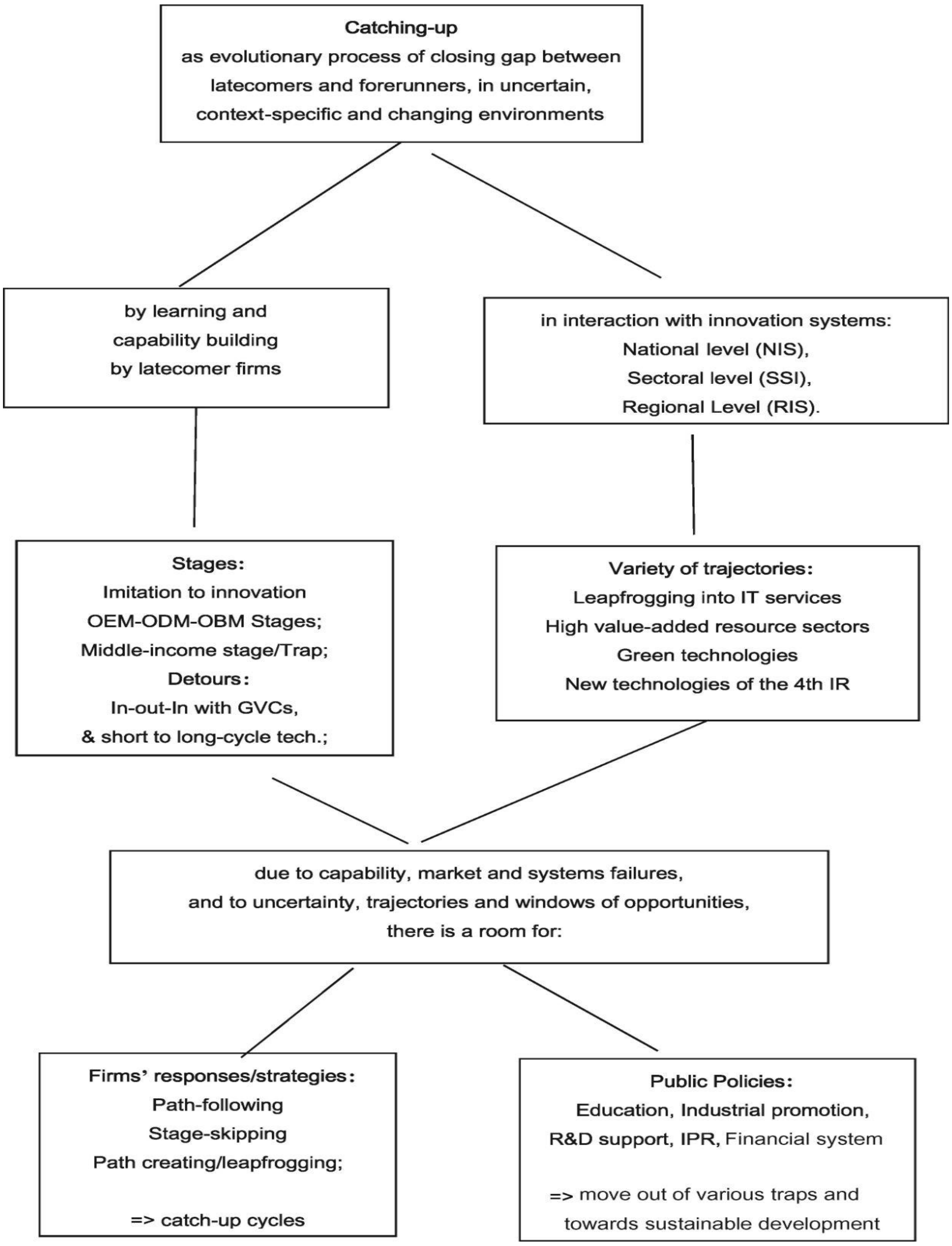
Figure 3. Domestic firm participation in chains for non-global brands



Source: Author; red indicates little no opportunity for domestic firms; yellow represents some opportunity; green indicates primary opportunities.

Source: Stacey Frederick, 2023

Appendix 4: Evolutionary Process of Catching Up



Source: Malerba and Lee, 2021

Appendix 5: Gathered Insights from Ecosystem Players in Private Investing

5.1 Discussion with U.S. based Venture Capitalist

Question: *What parameters are you looking for when invesing in a developing or middle income country? And how do Investment Policies in the country affect your decision?*

Answer: *Always about the potential return and market viability of the solution is what we look for. Developing Countries are actually very attractive places to invest right now because there's still a lot of potential for growth and expansion in their region. But of course there are other factor we consider before investing. Even though there is a potential high return from a private company but there is a weak investment infrastructure in the country such as incentivizing the investors tax, ease in equity ownership for foreigners and exit points, we will think twice before going for it.*

5.2 Discussion with an Investor and Portfolio Manager at a Global Venture Capital Firm

Question: *What parameters are you looking for when invesing in a developing or middle income country? And how do Investment Policies in the country affect your decision?*

Answer: *"Market fundamentals are always important — such as general performance of the economy, trajectory of GDP per Capita, company formation, availability of talent, etc. — they alone are not enough to make a market "investable". there are factors related to market dynamics. One of the key considerations for investing in a middle income / developing country is whether or not there have been significant exits of Venture-backed companies in that country. This becomes even more important for Growth-Stage investors writing larger checks, because as the companies get bigger, the larger the exit has to be -—Usually one would want to see both large IPO's, and large M&A transactions with exited companies being valued the $1B+ market cap* *range before considering investing in anything Growth-Stage in that country. Lack of precedent of exits in a country makes an investor skeptical of whether or not they can get liquidity on their investment and whether the potential holding period is practical [i.e. within the fund life]. Usually, one would also look at the level of competition for the deals. Availability of capital is a good thing, but sometimes the hype surrounding a certain market could unwarrantedly cause large amounts of capital [foreign and domestic] to come flooding in, raising valuations to frothy levels — which will lower expected returns. Sometimes you have a market with great economic fundaments, but no meaningful history of exits and a huge amount of valuation-insensitive foreign capital pouring in; A venture capitalist may end up "stuck" in their investment, unable to exit, or realizing poor Multiples on Invested Capital upon an exit due to an elevated entry valuation.*

While a country's investment policies cannot override market fundamentals and other factors, they can definitely end up being a barrier and some regulatory policies can end up being deal-breakers. Tax policy is often a primarily consideration. For example, if the country's tax system punishes Capital Gains with a very high tax rate, that would often disincentivize Venture Investors, given that the primary source of return for a VC fund is through an exit of the portfolio company, if a foreign shareholder [i.e. a foreign VC fund investing into the market] would have to pay a Capital Gains tax at the local level, and then again in their home market, it would often eat up enough of the potential return to become a deal-breaker. A government that fosters Pro-Competitive behavior (as opposed to Anti-Competitive behaviour) is also important. If the government intervenes whenever the incumbent is challenged by a startup, this is discouraging to new company formation and calls into question whether or not an investor will make money backing a startup for fear of the government stifling new companies challenging the incumbents. Some government policy can be more of a "carrot" for investors to deploy capital into a certain market. For sample, economic incentives for foreign funds that invest into a specific market [.e. Prreferential tax treatment] can change the economics of the potential outcomes on investments for the better, which would encourage many investors to fund startups that would cause them to qualify for this incentive."

5.3 Discussion with a Founder of a Philippine-based Fintech Platform

Question: *What are the challenges in the Philippine Ecosystem when it comes to investing in business ventures or Startup?*

Answer:

"I think one challenge is the Ease of Doing Business. Even with the Ease of Doing Business Law, it is still quite challenging to get all the required government permits from the various agencies when launching a new business and venture. Many government agencies, banks and enterprises still rely on paper-based processes for regulatory licensing or even for contracts.

We are a Philippine company serving the Filipino market but we registered an entity in Singapore [because] they have a friendlier infrastructure for taking in foreign investments for startups. We raised our Series-A through [our] Singapore entity. Investors know we are a company in the Philippines but for them to invest in us, we should be registered in a country that gives them ease of doing business."

5.4 Discussion with a member of a government-backed agency in Malaysia (Representative agreed to reuse this insight from an interview in April 2023)

Question: *What do you think is a good investment infrastructure in SG that is not present in Malaysia or Kaula Lumpur?*

Answer:

"Malaysia is good in running incubators but for scaling in the region, it's Singapore. Grab did not get any investments from local investors, they moved to SG for the funding they require to scale up. Hence, Grab is arguably known as a Singapore unicorn and not Malaysia. Grab did get seed funding when they [were] MyTeksi since it's a smaller fund size, after that, [a] lot of Startups in Malaysia need to raise funds from investors outside [the country]. Malaysia is seen as the incubator, but to scale up, they move out [of the country], usually to Singapore. To sum it up: Incubators and seed

funding are available locally, to scale up means go to Singapore, to serve a bigger market means [go to] Indonesia."

5.5 Discussion with a former regional innovation head of a South East Asia (regional) Accelerators, also an Indonesia Startup Ecosystem Player, and currently a Venture Scout for a U.S. based accelerator

Question: *What are the known opportunities and challenges for investing in Indonesia?*

Answer:
"Opportunities are the following:
- Thriving Middle Class: Indonesia boasts a large and continuously growing middle class. This segment is dominated by a young adult population, indicating significant spending power and potential for future growth.
- Digital Boom: Internet and mobile usage in Indonesia is on a consistent upward trend. This creates a fertile ground for startups offering tech-driven solutions.
- Flourishing Startup Ecosystem: The presence of established Startup Accelerator Operators (SAOs) like Skystar and Antler indicates a supportive environment for nurturing new ventures.

There are four challenges in investing in the country, first is regulatory uncertainty, then infrastructure limitations, intense competition for fund seekers, and talent drain.

In terms of Regulatory Uncertainty, frequent changes and unclear regulations, particularly in emerging sectors like green tech, pose a significant challenge. This makes it difficult for startups to navigate the landscape and for investors to confidently predict returns. Intense Competition: Indonesia's startup scene is highly competitive, with a growing number of ventures vying for funding and market share. Investors need a keen eye for identifying startups with a unique value proposition and strong competitive edge.
Infrastructure limitations because of having patchy digital infrastructure, especially [in] major cities, can hinder nationwide reach of starting a business. Additionally,

Indonesia's vast archipelago geography presents logistical challenges for physical infrastructure. Talent Drain: The country experiences brain drain in specific sectors, with highly skilled professionals seeking opportunities abroad. This creates a talent gap that can impede the growth and scalability of startups."

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