



Foreign Direct Investment for Development: Making Globalisation Work for the Poor

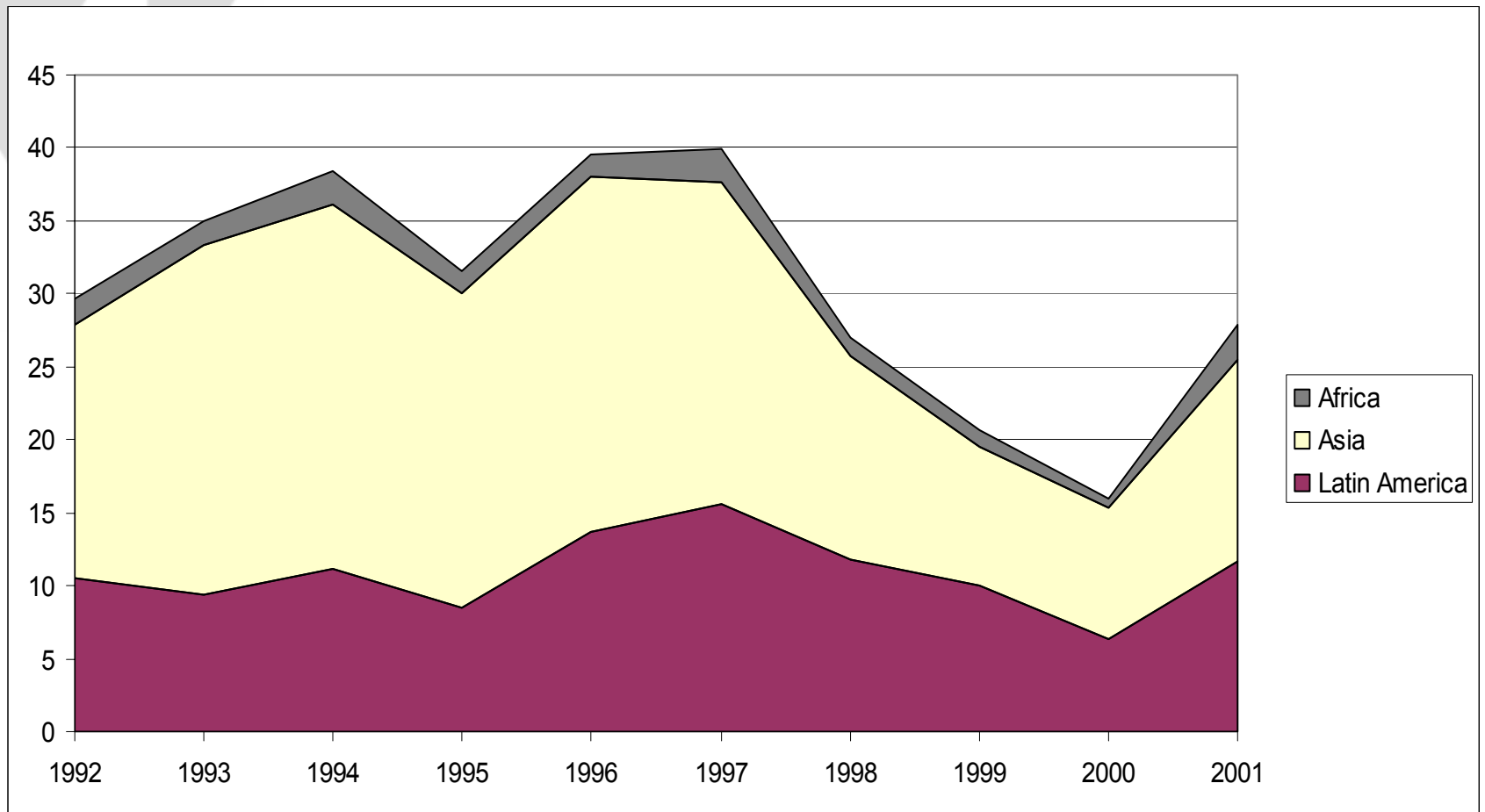
*Presentation given at the International House of Japan, Tokyo,
18 October 2002*

Hans Christiansen

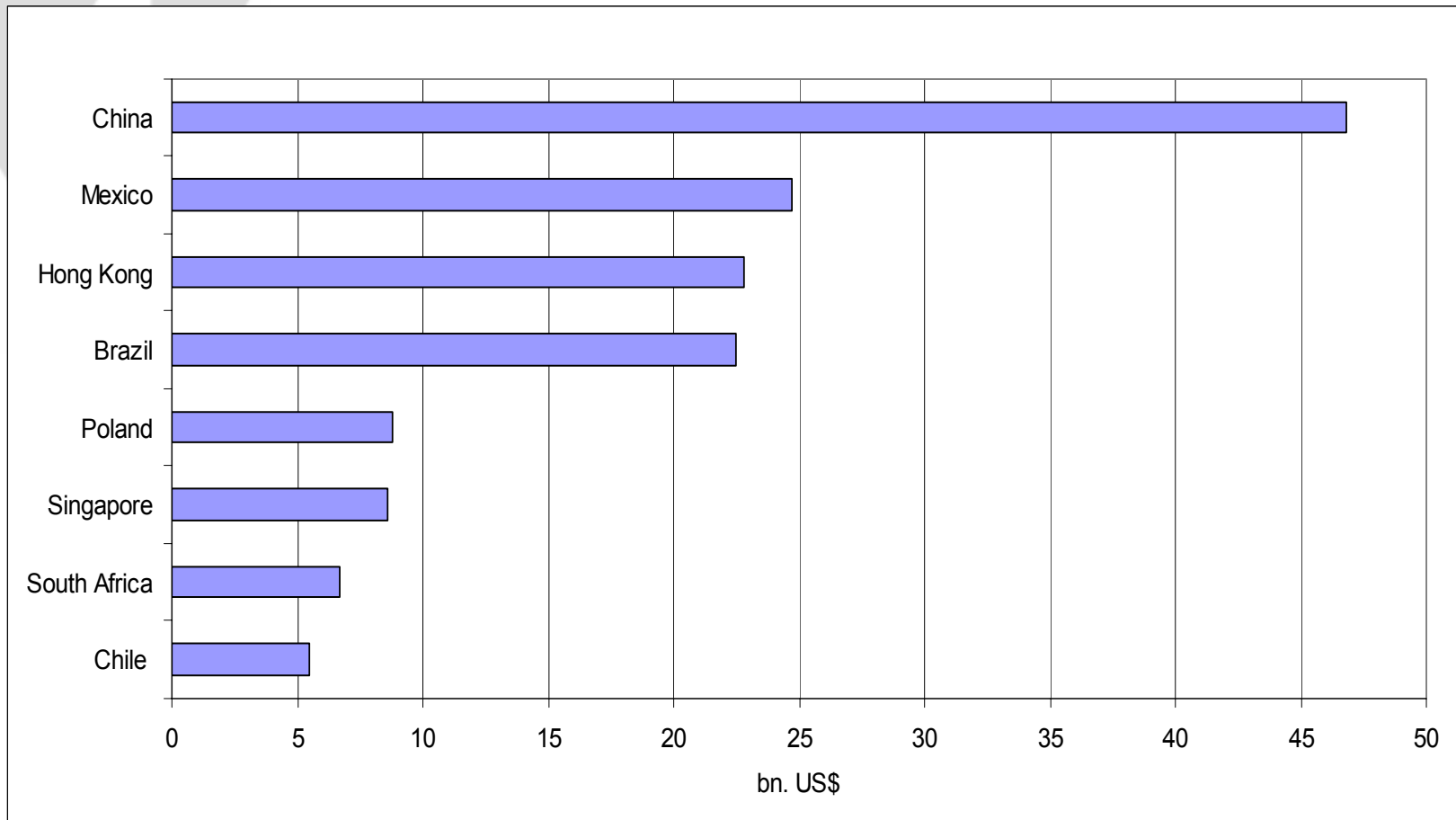
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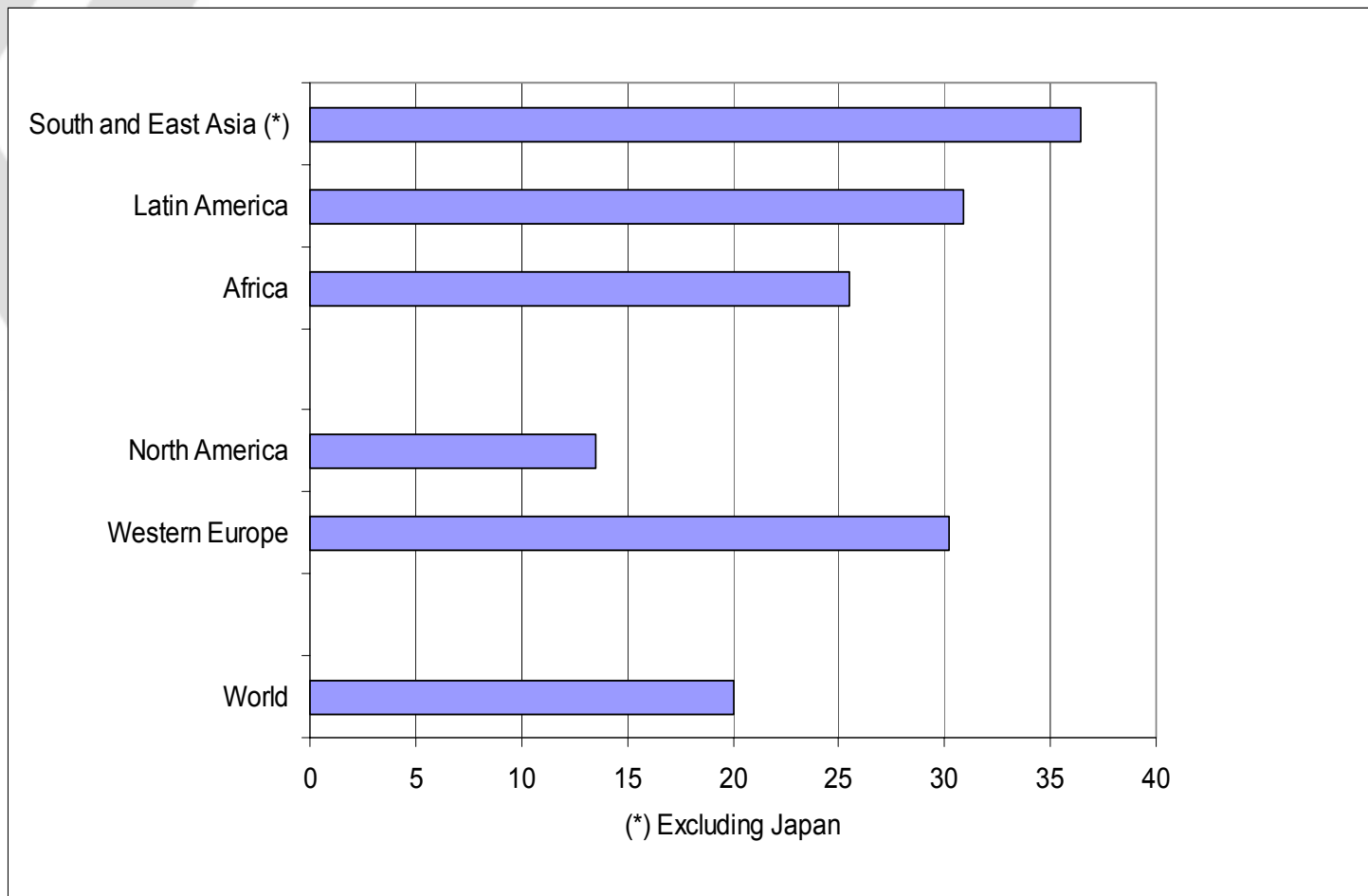
Developing countries' share of global FDI inflows



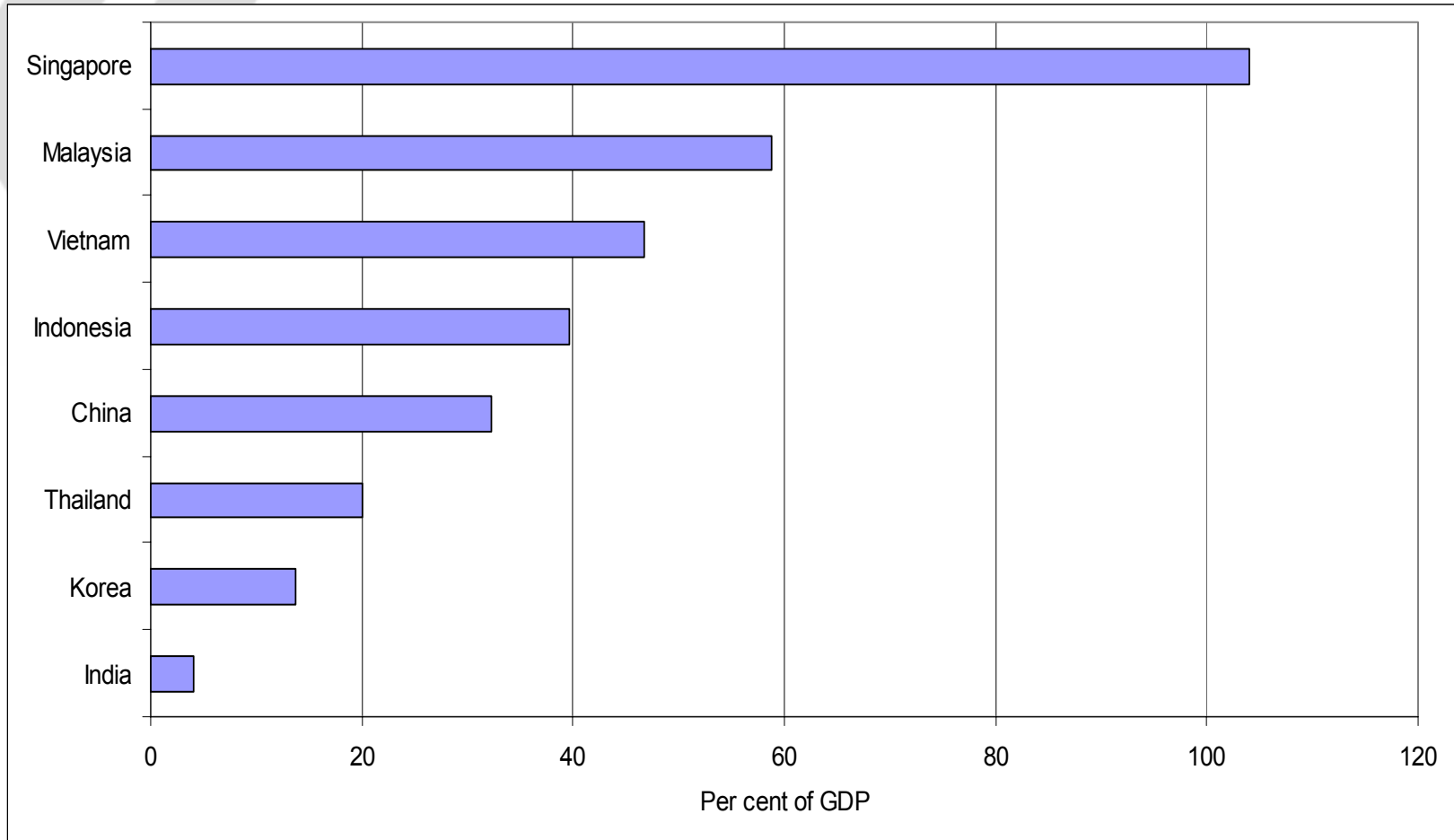
Largest developing country recipients of FDI



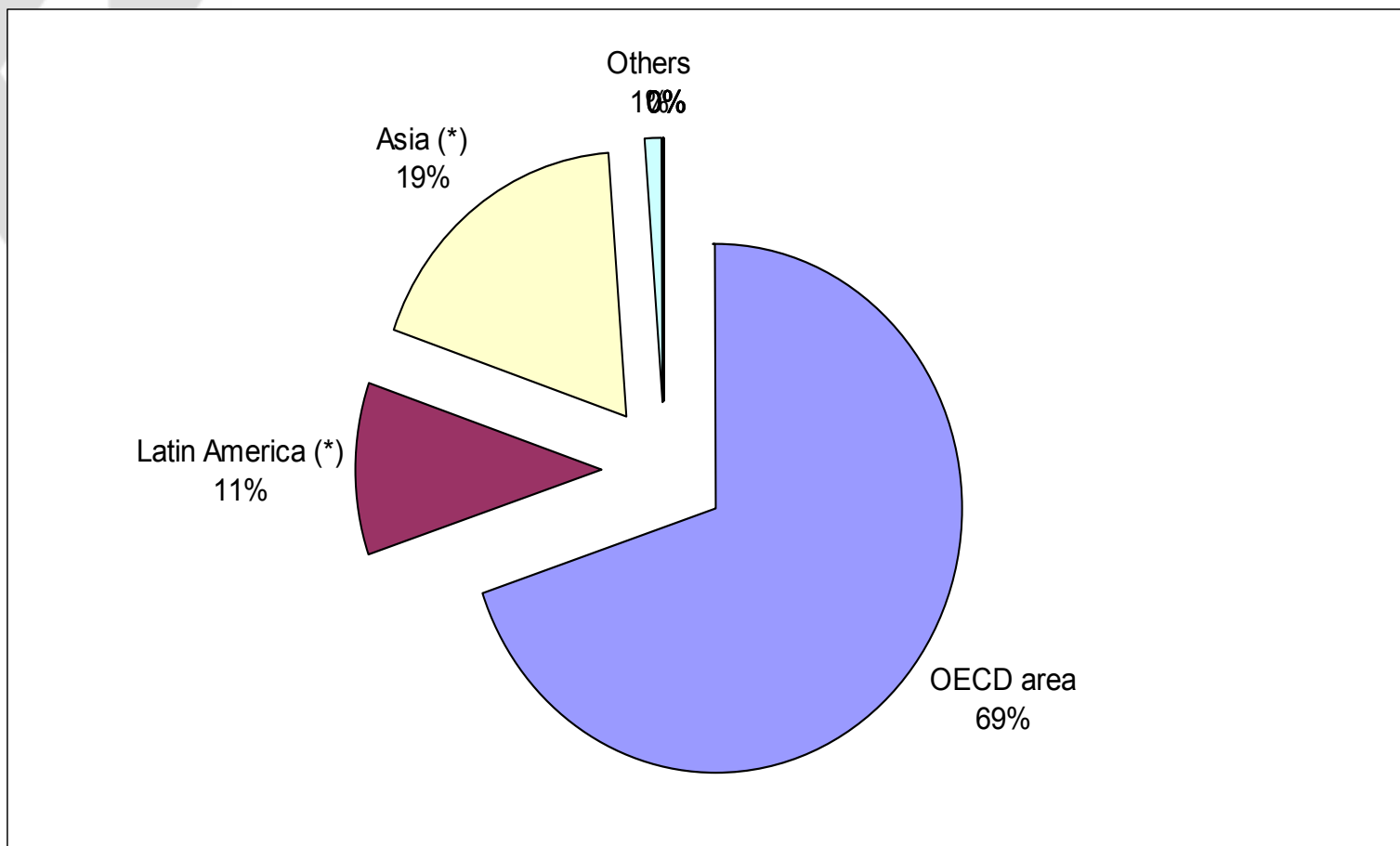
Inward FDI positions relative to GDP



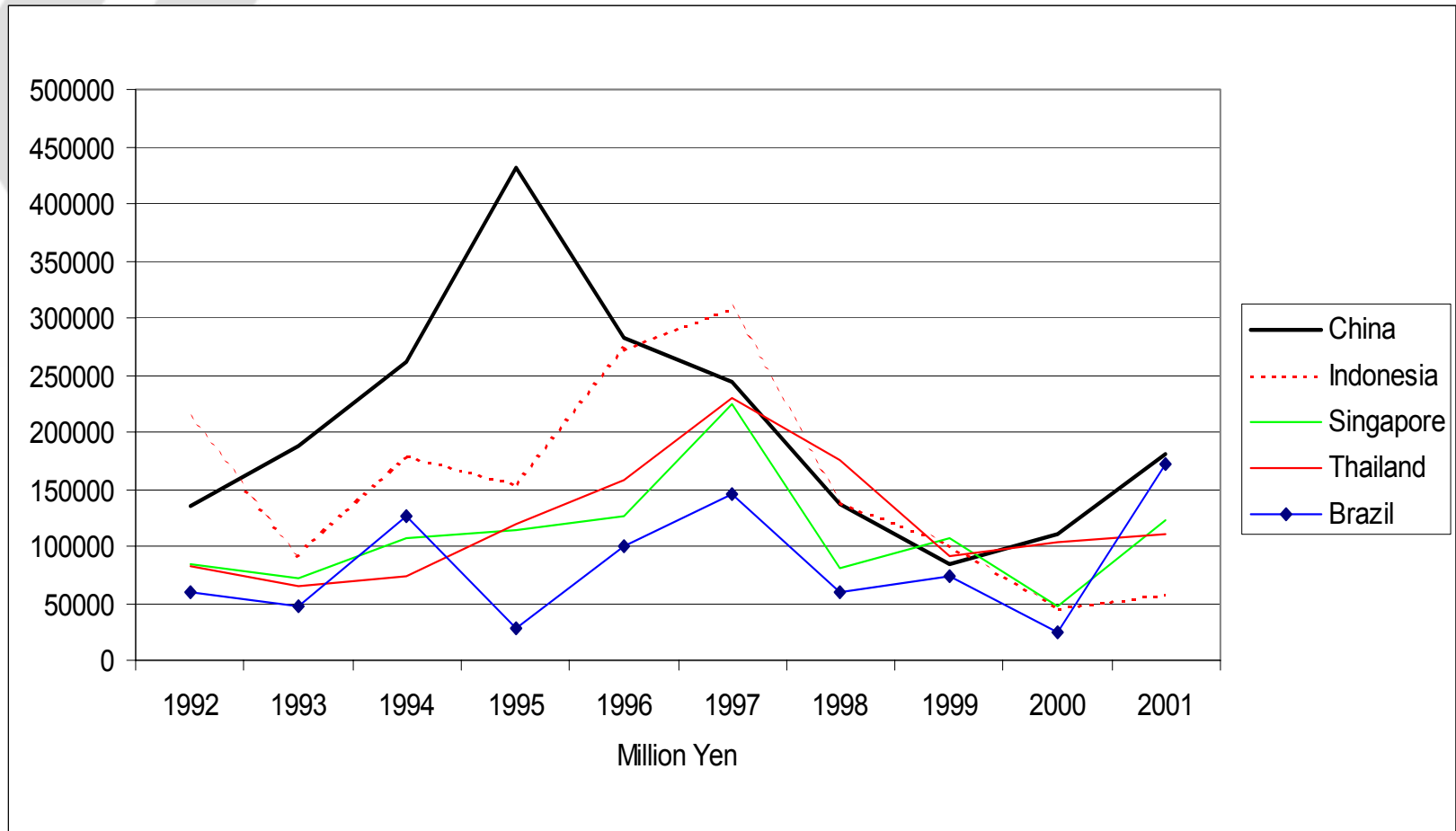
Inward FDI positions of selected Asian countries




Japan's outward FDI 1992-2001: by main regions

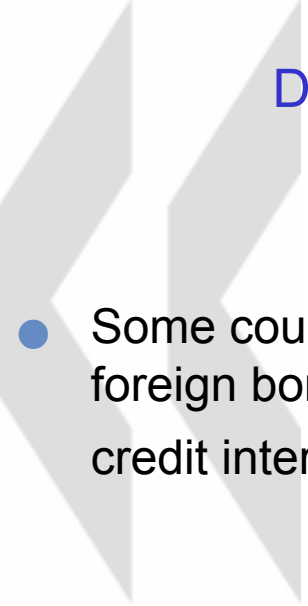


FDI from Japan to selected developing countries



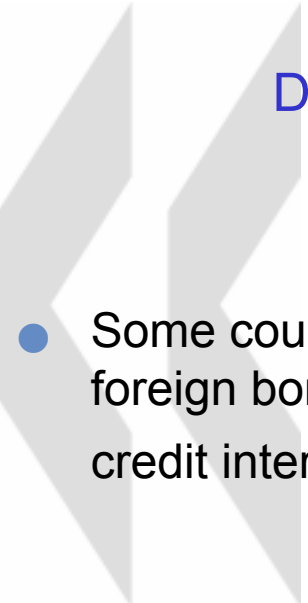


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What’s the difference?



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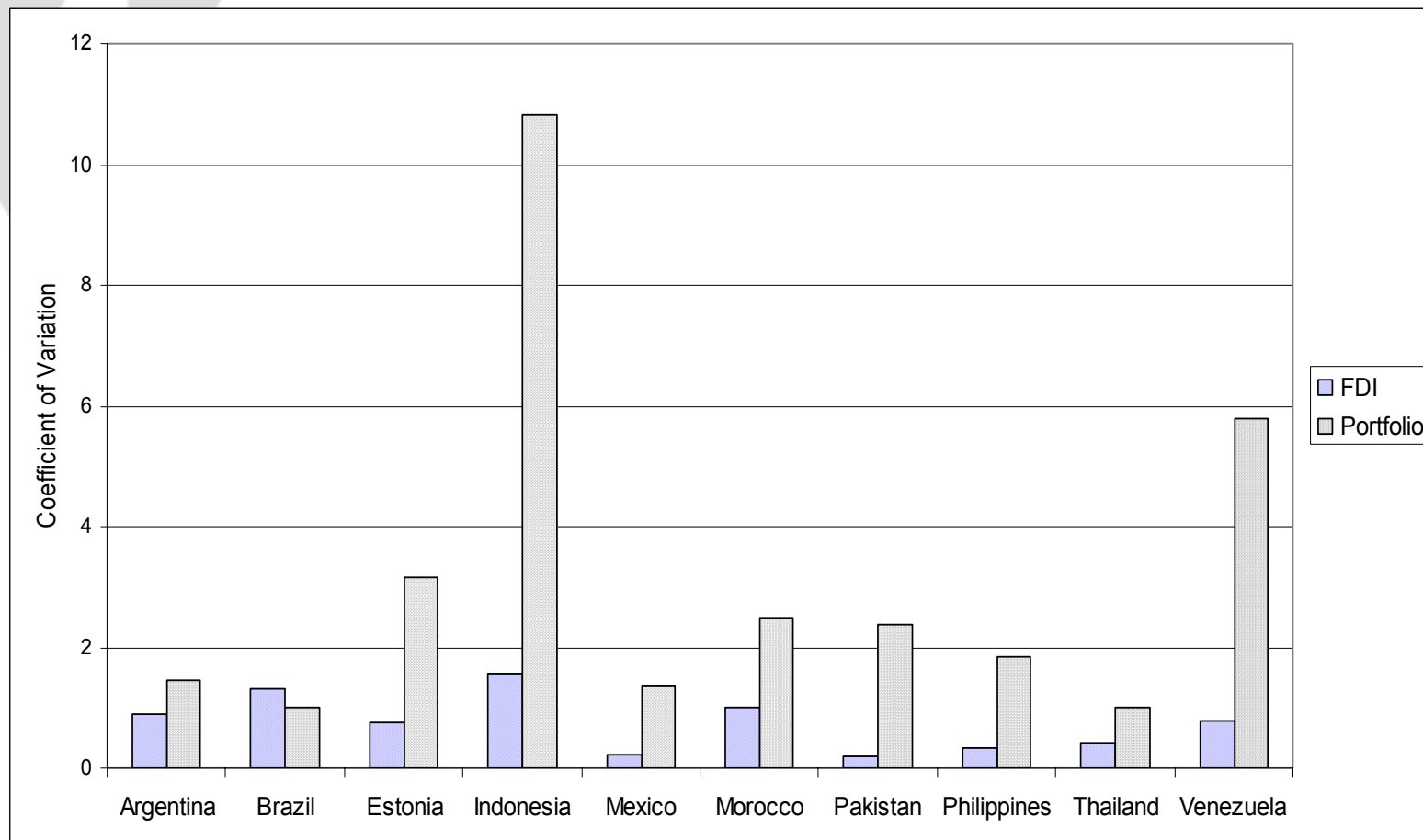
- Some countries have insufficient domestic savings and little recourse to foreign borrowing. Others have sufficient funds, but weak domestic credit intermediation.

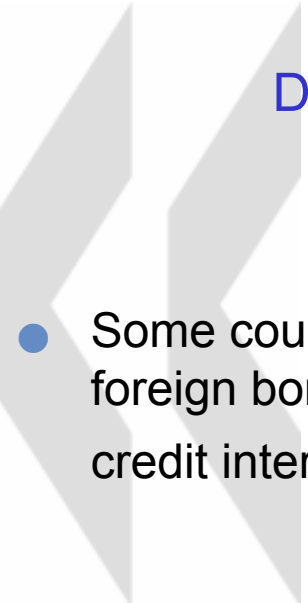


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- Some countries have insufficient domestic savings and little recourse to foreign borrowing. Others have sufficient funds, but weak domestic credit intermediation.
- Other countries have ample access to borrowed funds, but prefer to rely on a degree of equity finance. FDI is a more stable source of external finance than most.

Comparing the volatility of FDI and portfolio investment (over the last decade)





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- Other countries have ample access to borrowed funds, but prefer to rely on a degree of equity finance. FDI is a more stable source of external finance than most.
- All countries can potentially benefit from foreign corporate presence in their business sector. The benefits are both direct and indirect. They occur via three separate channels.

The Benefits (and Costs) of FDI for Development: Main Channels

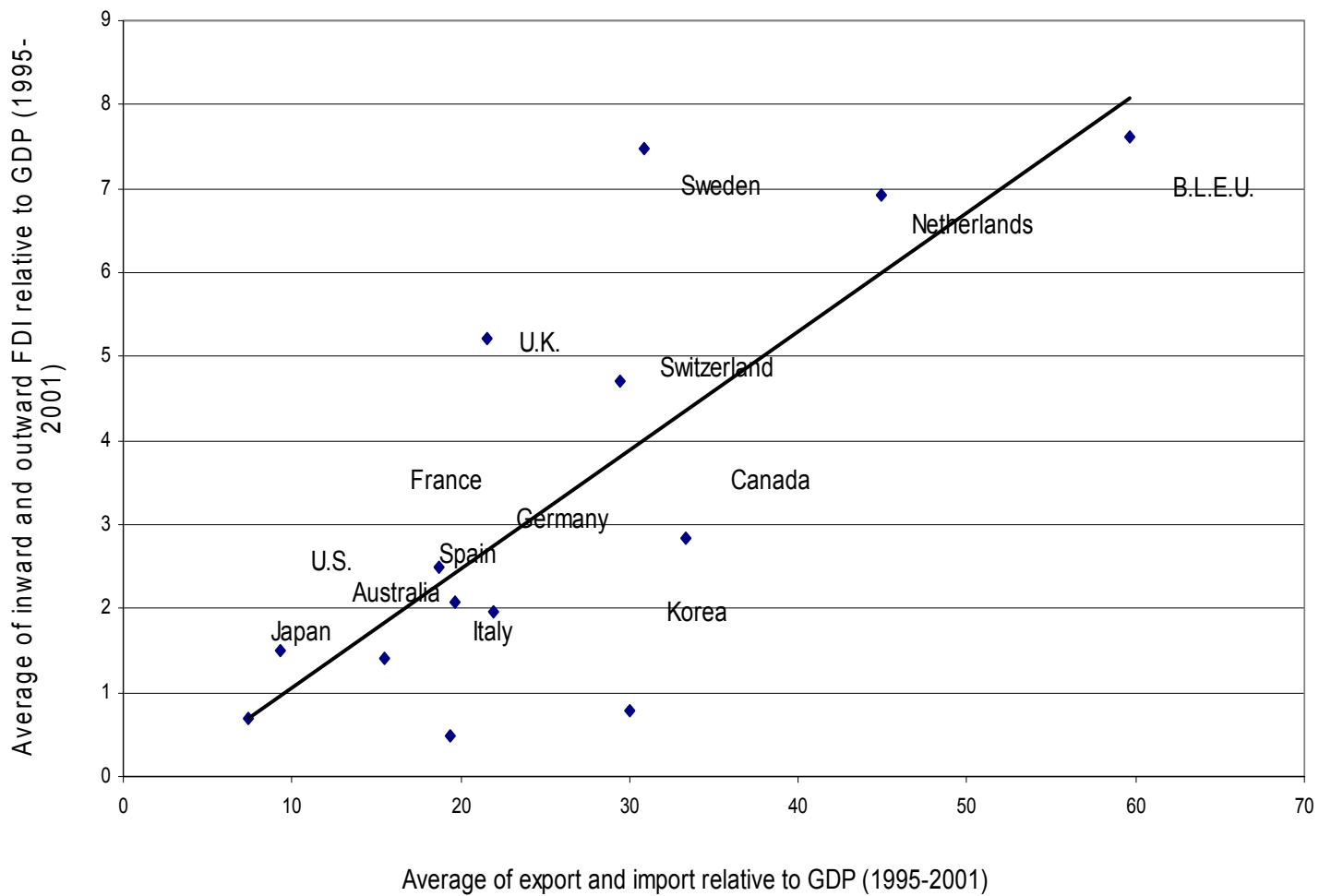
Economic growth (and factor productivity):

- **Integration in international trade. The question is not trade OR investment. The two reinforce each other.**
- **Spillovers due to foreign corporate presence. This includes technology diffusion and human capital development.**
- **Direct impact on corporate efficiency. Competition may be affected both positively and negatively by foreign entry. The effect on enterprise development and restructuring is consistently positive.**

FDI and host country integration into international trade

- **Foreign trade and FDI are complementary. In the longer run, increasing inward investment boosts exports as well as imports.**
- **The benefits of FDI are therefore equivalent with the ones that arise from increased openness to trade.**
- **Countries may exploit this through reliance on special entities such as export processing zones. However, this comes at a non-trivial cost.**
- **Policies aimed at harnessing FDI as a tool for limiting imports or boosting exports have not been generally successful.**

Openness to trade and FDI



Foreign corporate presence and spillovers to the host economy

- **Technology may be transferred or emulated locally...**
 - **Vertical linkages with suppliers**
 - **Horizontal linkages with competing or complementary companies**
 - **Migration of skilled labour**
 - **Internationalisation of R&D**
- **...but not all foreign technologies are equally relevant.**
- **Human capital spillovers are common, but not often decisive**
 - **Foreign-owned enterprises offer more training, but the training is often not widely applicable.**
 - **Demonstration effects *vis-à-vis* local authorities.**
 - **Migration of managers.**
- **Human capital and technology levels are interrelated...**
- **...and they are both contingent upon the presence of certain minimum thresholds in the host economy.**

FDI and efficiency gains: competition and enterprise restructuring

- **Market concentration has increased significantly in response to M&As...**
- **...but this does not necessarily imply that competition suffers...**
- **...especially not where the appropriate (foreign trade, anti-trust) policies are in place.**

- **Foreign-orchestrated takeovers generally result in better management and corporate governance practices...**
- **...and efficiency gains more generally, especially in sectors with economies of scale.**
- **Foreign participation in privatisation has generally been successful, but often also politically controversial.**

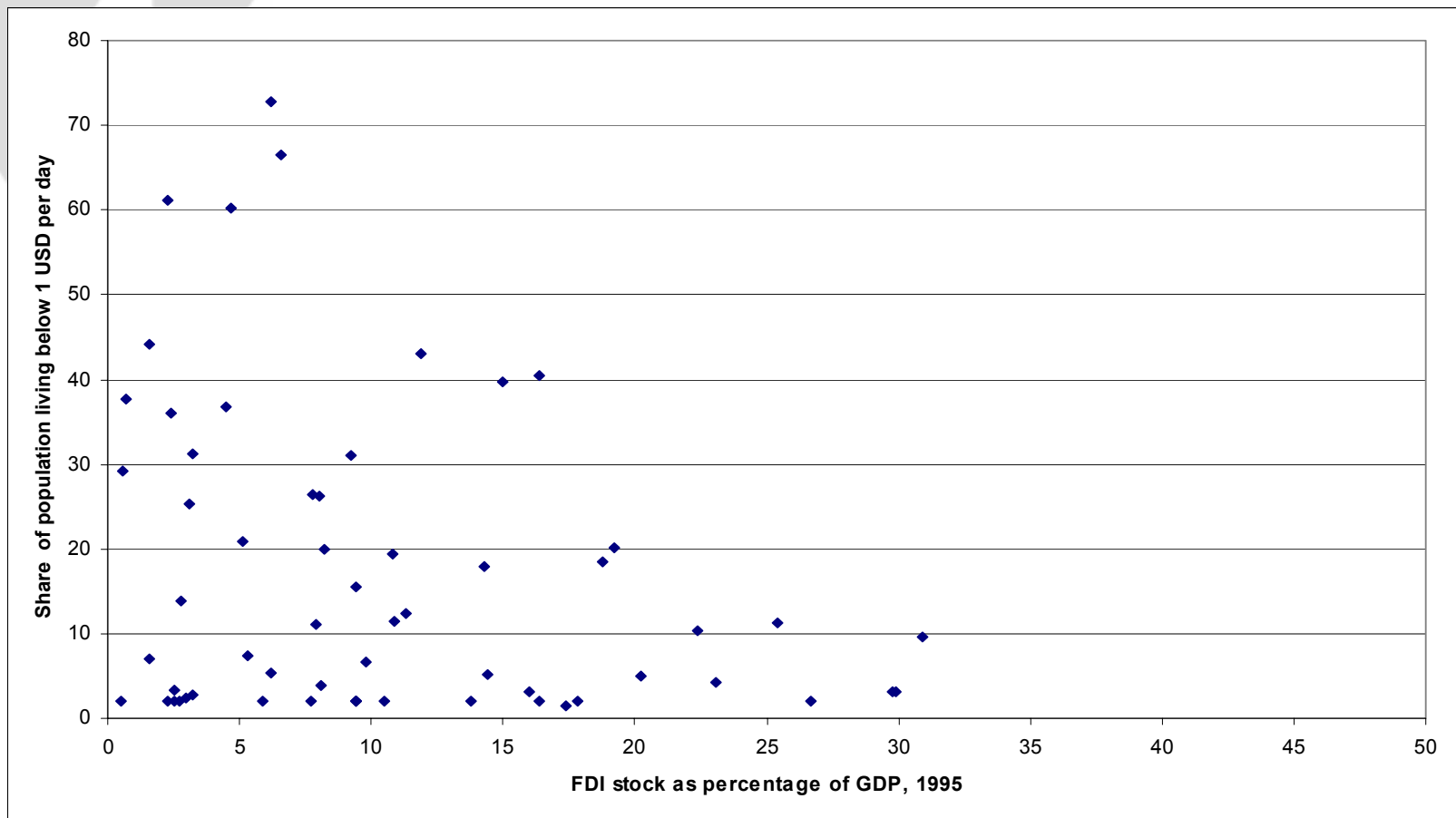
Environmental and social concerns

- **MNEs are well placed to apply environmentally sound practices, and they generally obey host country laws and regulations...**
- **...but they have little incentive to take the lead. Appropriate domestic regulation is hence very important.**

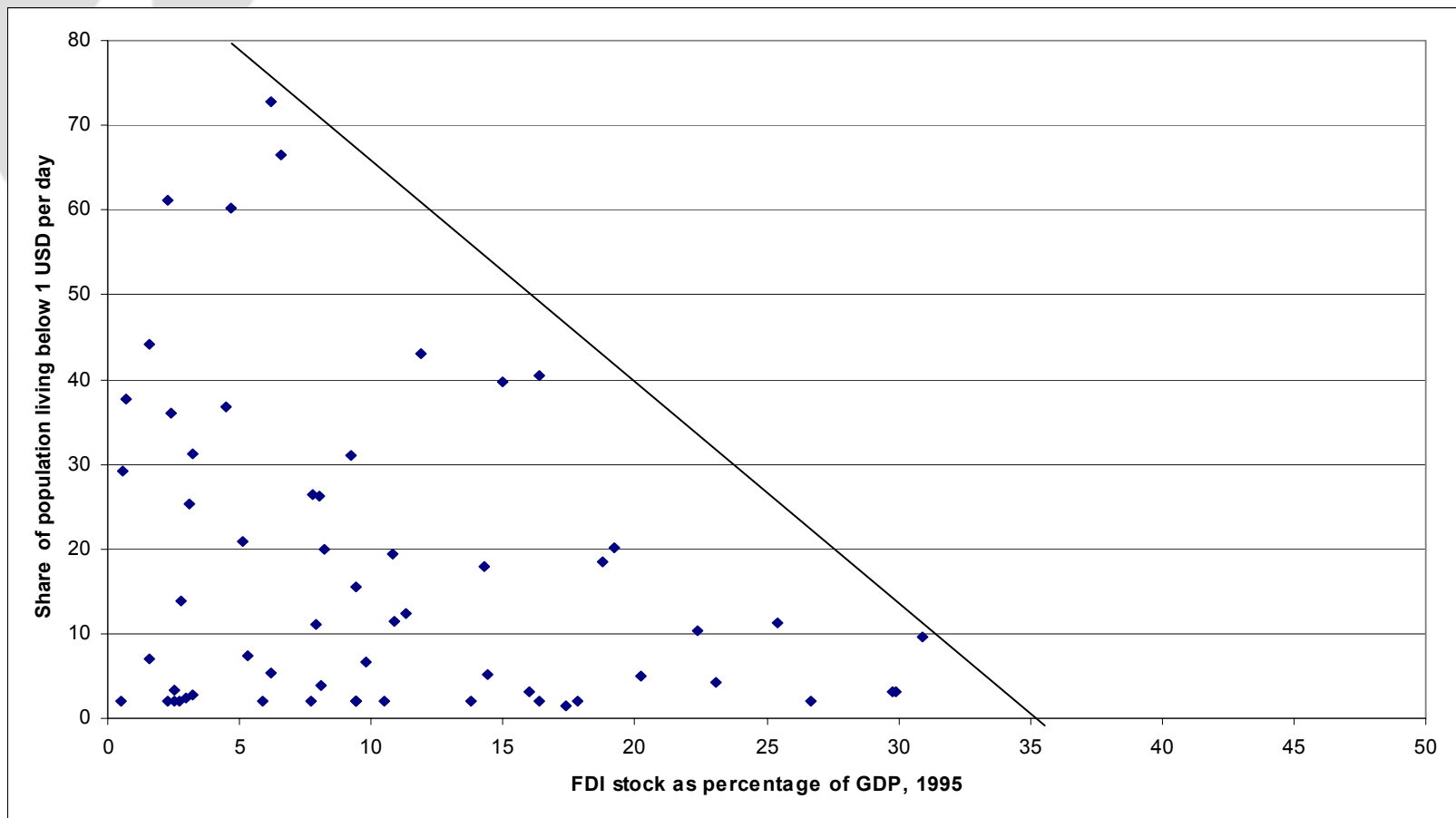
- **There is very little systematic evidence of “pollution havens” and “race to the bottom”...**
- **...whereas some anecdotal evidence remains subject to dispute.**

- **FDI generally helps raising social standards in the host country...**
- **...and there are signs of a positive correlation between FDI and core labour standards...**
- **...but some controversy continues to surround export processing zones.**

Poverty and inward FDI stock (in 60 developing countries)



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What may host countries do about it?

Overall: Every aspect of host countries' economic and governance practices affects the investment climate. The following policy action toward macroeconomic stability and institutional predictability should be priority:

- Pursue sound macroeconomic policies geared to sustained high economic growth and employment, price stability and sustainable external accounts.
- Promote medium-term fiscal discipline, efficient and socially just tax systems and prudent public-sector debt management.
- Strengthen domestic financial systems in order to make domestic financial resources available to supplement and complement foreign investment.

What may host countries do about it?

Investment climate: FDI is unlikely unless investors have a reasonable understanding of the environment in which they will be operating. Moreover, foreign-owned enterprises need to be able to deal with domestic business sector as well as related enterprises abroad in a fair and rational manner. Authorities need to consider the following challenges:

- Strengthen ongoing efforts to consolidate the rule of law and good governance.
- Work toward increased openness to foreign trade so that the domestic enterprise sector can participate fully in the global economy.
- Enshrine the principle of non-discrimination in national legislation and implement procedures to enforce it through all levels of government and public administration.

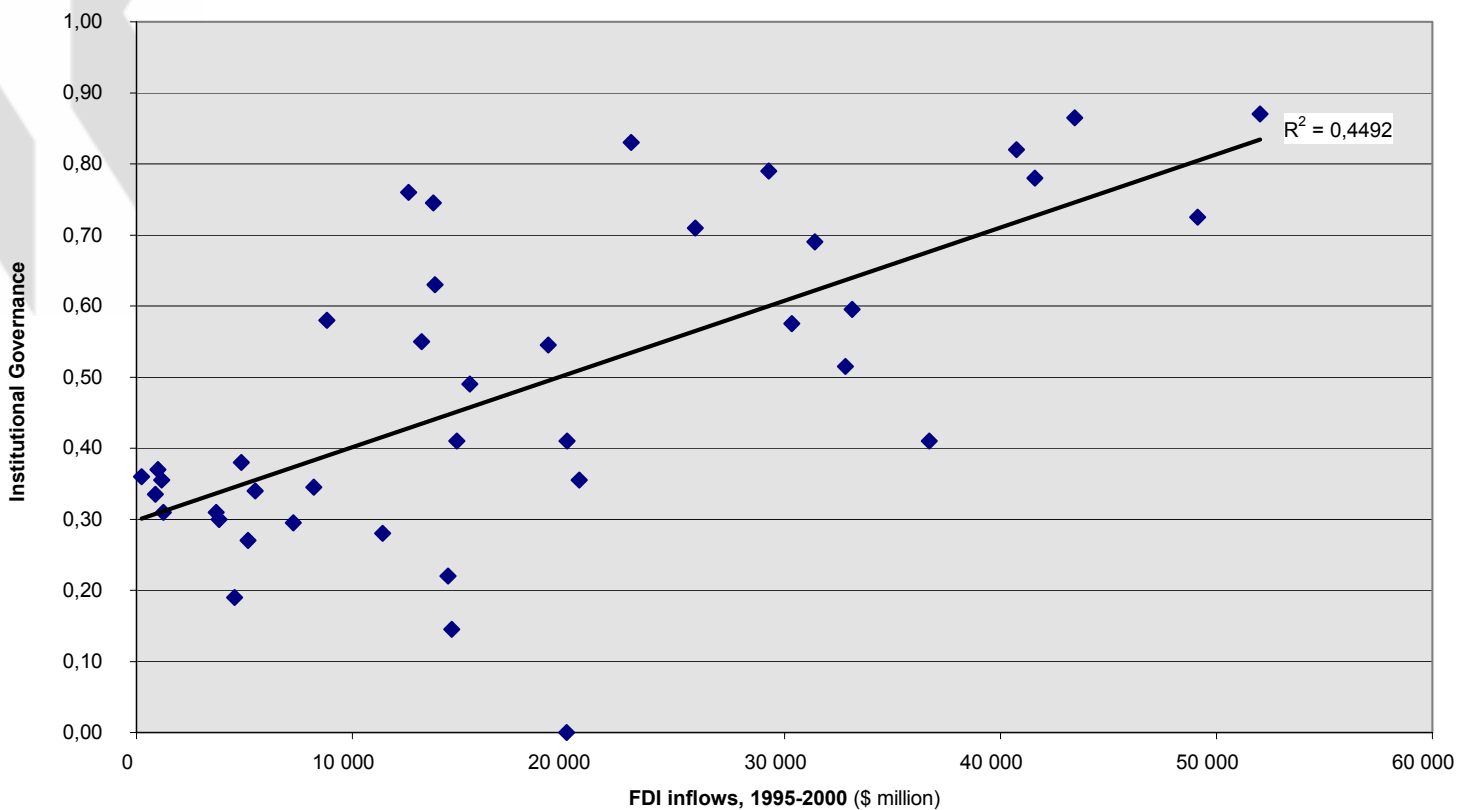
Attracting FDI: Relative Importance of Key Factors

- **Confidence in the rule of law**
- **Quality of macroeconomic environment**
- **Political stability**
- **Quality and clarity of business legislation**
- **Sector/industry specifics**
- **Administrative burden**
- **Social coherence and infrastructure**
- **Local labour market conditions**
- **Social network (e.g. for expatriates)**
- **Business infrastructure**

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Inward FDI and the quality of institutional governance



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Encouraging spillovers: Domestic competences, technologies and infrastructures need to be sufficiently well developed to allow nationals to take full advantage of the spillovers foreign-owned generate. Hence, host country authorities should consider undertaking certain measures:

- Put in place, and raise the quality of, relevant physical and technological infrastructure.
- Raise the basic level of education of national workforces.
- Implement internationally agreed standards in areas such as child labour, workplace discrimination and impediments to collective bargaining.