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REPORT OF THE EXPERT MEETING ON FDI AND DEVELOPMENT

Held at the Palais des Nations, Geneva
from 29 to 31 October 2003

CONTENTS

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Chapter I

CHAIRPERSON’S SUMMARY

1. In accordance with the agenda of the meeting, the discussions focused on the role of foreign direct investment (FDI) in the development of services industries and related policy challenges. The first day's debate revolved around general issues concerning services, FDI and competitiveness, and the growth of export-oriented FDI in services. The remaining two days concentrated on the role and impact of FDI in the context of privatization of services.

2. The meeting took note of the growing importance of services in the economies of countries and their increasing contribution to world trade. Services often represent the largest sector of the economy, and they are also central in FDI, now accounting for the majority of the stock of inward FDI in both developed and developing countries. Several experts argued that the importance of FDI in services had not been adequately reflected in research and policy analysis. Policy formulation in services needs to go beyond the standard economic analysis focusing on enhancing productive capacity and competitiveness, because services are deeply embedded in the social, cultural and political systems of societies. Experts agreed that both analysis and policy formulation needed to reflect the wide diversity among different kinds of services.

3. Regarding competitiveness, the question is how it can be measured in services industries. It was argued that price, quality and productivity were important variables in measuring competitiveness in services. Related issues are whether to refer to competitiveness of countries or of enterprises, and the role of the state in promoting competitiveness.

4. Even in the absence of a precise definition of competitiveness in services, there was agreement that services could have a major impact on the competitiveness of an economy. Some services are internationally tradable and can be exported, adding to the export competitiveness of countries. More importantly, many services are inputs into the production of goods and other services produced locally, affecting their cost and quality. In addition, since many services are final consumer products, their cost and quality (as well as their availability) affect the standard of living of the local population. The question arises, therefore, whether Governments in developing countries should formulate a competitiveness strategy for services and, if so, what its principal components should be.

5. Transnational corporations (TNCs) can affect the provision of services in various ways. They can provide capital and foreign exchange, develop critical support activities, and introduce best practices as well as technology, with important demonstration and other spillover effects on local enterprises. This can result in better and cheaper services as well as the introduction of services not available from domestic suppliers. Through privatization, FDI can also help restructure ailing state-owned enterprises, bring in necessary capital and know-how, and increase governmental budget revenues. But these benefits are not automatic, and there may also be costs. There are concerns that FDI may (as, for example, in the retail sector) crowd out local companies and have adverse socio-cultural effects. Some forms of

FDI may be footloose. Moreover, lack of investment in local skills development and formation of linkages overseas rather than locally may reduce positive spillovers. The risk of negative balance-of-payments effects from FDI in non-tradable services was also referred to. In terms of privatization, some concern was voiced regarding employment effects and the risk of formerly public monopolies being converted into private foreign monopolies.

6. At a general level, a number of policy areas were noted as important for attracting and benefiting more from FDI in services, including the level of liberalization, the general business climate, and the legal system (intellectual property rights). It was argued that transaction costs were more important for services FDI. Other conditions of benefiting from FDI include the development of local skills; the development of a modern infrastructure, especially in the information and communication technologies (ICT) area; the promotion of localization of FDI and linkages; and proper regulation of service industries, especially utilities.

7. There was some discussion regarding the WTO General Agreement on Trade in Services (GATS). Some experts noted that developing countries had not made many commitments in the GATS and suggested that this might hamper the ability of these countries to benefit fully from FDI in services. Other experts argued that GATS commitments were not a good proxy for a country's openness to FDI in services, as many countries had chosen to liberalize services unilaterally without binding such liberalization under the GATS, perhaps in part owing to its inadequacy regarding an emergency safeguard mechanism. Some developing countries might also prefer to improve their domestic enterprises’ competitiveness rather than rely on FDI when strengthening their services sectors.

8. An important characteristic of most services is that they are neither tradable across borders nor storable, and must therefore be produced when and where they are consumed, making FDI the dominant means of supplying services to foreign markets. However, advances in ICT make possible the separation of production and consumption, increasing the tradability of services. This has facilitated the splitting up of service functions and their relocation to lower-cost locations abroad. These services include call centres, shared services centres, research and development, IT support and other back-office functions. This represents significant potential for developing countries in terms of exports and FDI.

9. In a session devoted to the potential from outsourcing of services, it was observed that a number of factors were important when companies decided where to locate call centres and other services for exports. These factors include the quality and cost of labour as well as a sufficient supply of it; the supply of energy and modern telecommunications services; local availability of relevant languages; availability and cost of office space; legislation on data protection; an adequate local transport system; in some cases, the level of taxes and subsidies; the overall cost of doing business; and political stability. Government policies are important for attracting and developing the desired kind of service activity as well as upgrading it. Key policy areas include skills development, a clear marketing strategy concerning investment opportunities, and removal of red tape and unnecessary bureaucracy.

10. Whereas China, India, the Philippines and a few other countries have been the main beneficiaries of the process of relocation of services functions to lower-cost locations, some experts argued that other developing countries, including small landlocked and island countries, could do the same. Some experts underlined that call centres and contact centres tended to be at the lower end of the value chain, whereas new opportunities were also emerging in more sophisticated activities, including software development and design. For the former type of activities, TNCs have considerable choice in selecting their locations, whereas fewer developing-country locations may offer the necessary conditions to attract and keep more advanced activities.

11. The discussion on experiences with privatization-related FDI in services highlighted that overall privatization activity in developing countries had declined after peaking in 1998. The largest transactions so far had taken place in Latin America, followed by Central and Eastern Europe. In terms of value, most deals had been undertaken in telecommunications, followed by electricity, transport and banking. In developing countries, asset sales (mostly involving FDI) had been the preferred mode of privatization, whereas share offerings dominated in developed countries. In addition to privatizations, the use of public-private partnerships, concession agreements, "build-operate-transfer" schemes, project finance and other methods of involving the private sector were discussed in the meeting.

12. In terms of impact, experts were of the view that, in the majority of cases, the privatization of services to foreign investors had improved firm performance and resulted in the provision of more competitive services. However, many also cautioned against raising too high expectations from privatization. Whereas the outcome may on average have been better than public perception had it, the end results had varied greatly. Moreover, the involvement of foreign investors had sometimes raised popular resistance and concerns that it implied “selling of the family silver" and unnecessary job losses. At the same time, it was noted that an alternative to involving foreign investors was sometimes hard to identify, which underscored the importance of regulation to maximize benefits.

13. Most experts agreed that the design and implementation of privatization processes affected the potential outcome. It was argued that privatization programmes needed clear formulation of objectives indicating why Governments wished to reach their development goals through privatization, and why foreign buyers (instead of local investors) should be invited. For each situation, all alternatives should be considered. In exceptional circumstances, such as transitions from planned to market economies, the impulse for privatization might be pervasive. Many experts stressed that, in light of significant differences between industries, there was no one-size-fits-all solution. For example, in the telecommunication industry, new wireless technology had changed the rules of the game, reducing the problems of competition associated with fixed-line telephony, while in the water industry competition remained the key concern.

14. Notwithstanding the diversity of industries, some common dilemmas were highlighted. One related to the overall objective of privatization. To what extent should Governments aim at maximizing budget revenues or other objectives, such as

competitiveness, preservation of employment or universal provision of services? In some instances, there could be a difficult trade-off between maximizing the sales price of the company to be privatized and future performance requirements and commitments. For example, considerable attention was devoted to the question of exclusivity periods, which could help increase revenues but could also have adverse effects on the efficiency of the service industry. It was generally held that, if there was a need to offer an exclusivity period, it should be kept as short as possible in order to facilitate competition.

15. In order to maximize the beneficial effect from privatization of infrastructure services, the question of how the revenue obtained was used by Governments was referred to. In the case of vital services, such as water, some experts advocated that the proceeds might be best invested in the company privatized or used to subsidize poor consumers, in order to ensure sufficient provision of the service to all consumer groups.

16. Some experts argued that Governments should seek to maximize competition among potential bidders for a given asset – for example, through carefully designed auctions. Others believed that a higher offer price would indicate a more serious commitment on the part of the potential investor to upgrading the acquired assets in the future. It was noted that in certain industries and for small and less-developed countries, competition could be hard to achieve. For example, in the water industry, the dominance of only a few TNCs implied a small number of bidders. Other experts noted that few African countries had been able to attract any interest from foreign companies in investing in the power industry.

17. A difficult issue was related to the degree and nature of performance commitments imposed on investors. Some experts stressed that everything was negotiable, but at a price. Too many commitments, especially soft ones, might be difficult to enforce and could lead to a reduction in the revenue obtained from privatization. Thus, there was a need to find the right balance.

18. The discussion also highlighted many questions of a technical nature – for example, related to the sequencing and the forms of privatization. Should companies be sold in one piece or sequentially? Do share issues provide better results than asset sales? Should Governments restructure companies before selling them to foreign buyers? Consideration was also given to the transparency of the privatization process, the risk for corruption, and the impact of large privatizations on the development of the local capital market.

19. On the issue of regulation, the main dilemma is related to services that are natural monopolies. In these cases, policy makers and regulators often have to balance the conflicting goals of ensuring efficient provision of services while at the same time making sure that the services provided are accessible at affordable prices to the poor. There was general agreement that privatization in these industries should be preceded by the establishment of an appropriate regulatory framework and, if possible, by the breaking up of monopolies. The need to have regulatory bodies as independent and adequately resourced institutions overseeing the privatization and the post-privatization phase was undisputed. Weak

regulation often implied higher returns to private monopolies and increased the risk of regulatory capture.

20. Many experts debated the question of finding an appropriate tariff structure. The discussion focused in particular on the role of subsidies and whether demand-side or supply-side subsidies were desirable. While the latter were generally seen as being superior to the former, it was acknowledged that the design of tariff schemes and subsidies essentially required a case-by-case approach, even if much could be learned from existing evidence.

21. The discussion furthermore revealed that the issue of regulation was still at an early stage. Governments are exploring various innovative solutions to tackle the challenge of regulating services. Experience to date from developed as well as developing countries does not allow for identifying universally applicable best practice in this area. There was general agreement that the design of the regulatory framework had to be tailored to specific industries, as well as to take into account the specific situation in each country. A distinction was, for example, suggested between vital services (such as water) and non-vital services (such as telecommunications). Another important factor when designing regulatory frameworks was the size of a country and, with it, the question of whether certain services were commercially viable at all and to what extent potential competition existed.

22. The long duration of concession contracts for certain services was seen as another difficult regulatory issue. Whereas contracts often had to run over a multi-year period in order to ensure their commercial viability, the long duration implied that Governments (and, for that matter, firms) might find themselves locked into contracts that were difficult to adapt to changed situations over time – a frequent source of conflict between Governments, regulators and companies.

23. The role of different stakeholders in the regulatory process was considered too. It was noted that attention had to be paid to the role of the state (central and local), private companies (national or foreign, profit or not-for-profit), consumers (rich and poor) and the media. Some speakers argued in favour of giving consumer associations an active role to ensure that consumers' interests were adequately reflected. Others expressed doubts as to the usefulness of such associations, particularly in small countries and in those that did not have a history of such institutions.

24. While there was general consensus on the importance of regulation to ensure benefits from privatization, some experts stressed that the design and implementation of such regulatory frameworks constituted a major challenge for developing countries with weak regulatory capacity and limited resources. The possible role of international cooperation in the area of regulating services was also raised. In this connection, the need for technical assistance, including through the involvement of international organizations, was noted. Other ideas that were floated included the possibility of international cooperation among consumer interest groups; the development of a "code of conduct" for firms involved in privatization of sensitive services; and the establishment of an international regulatory framework.

25. At the end of the meeting, a roundtable was organized to discuss questions that should be kept in mind when privatizing with FDI in the services sector. In particular, experts debated issues related to the justifications for privatization; its political feasibility; and how to address political and public acceptance, competition and regulation, social implications and mechanisms of privatization. Most experts agreed that these issues should be considered taking into account country and sector specificities. In this respect, some experts highlighted the specific situation of LDCs, particularly some African countries, in attracting FDI in services. Nevertheless, the following issues emerged as most important when considering privatization: the role of privatization policy in a country's overall development strategy; the objectives of privatization; the importance of the regulatory framework and of strong and independent supervisory and privatization institutions; the level of domestic political support for privatization; and the identification of possible social costs of privatization and how to minimize them.

Chapter II

ORGANIZATIONAL MATTERS

A. Convening of the Expert Meeting

26. The Expert Meeting on FDI and Development was held at the Palais des Nations, Geneva, from 29 to 31 October 2003.

B. Election of officers

(Agenda item 1)

27. At its opening meeting, the Expert Meeting elected the following officers to serve on its bureau:

Chairperson:	H. E. Mr. Toufiq Ali (Bangladesh)
Vice-Chairperson-cum-Rapporteur:	Mr. Christopher Wilkie (Canada)

C. Adoption of the agenda

(Agenda item 2)

28. At the same meeting, the Expert Meeting adopted the provisional agenda circulated in document TD/B/COM.2/EM.14/1. The agenda for the meeting was thus as follows:

1. Election of officers
2. Adoption of the agenda
3. FDI and development
4. Adoption of the report of the meeting

D. Documentation

29. For its consideration of the substantive agenda item, the Expert Meeting had before it a note by the UNCTAD secretariat entitled “FDI and development: The case of privatization-related services FDI: Trends, impact and policy issues” (TD/B/COM.2/EM.14/2).

E. Adoption of the report of the meeting

(Agenda item 4)

30. At its closing meeting, the Expert Meeting authorized the Rapporteur to prepare the final report of the meeting under the authority of the Chairperson.

Annex

ATTENDANCE [*]

1. Experts from the following States members of UNCTAD attended the meeting:

Argentina
Australia
Azerbaijan
Bangladesh
Benin
Brazil
Bulgaria
Burkina Faso
Cambodia
Cameroon
Canada
China
Congo
Costa Rica
Czech Republic
Democratic Republic of the Congo
Egypt
Eritrea
Ethiopia
Finland
France
Gabon
Germany
Guatemala
Indonesia
Japan
Kenya
Lebanon
Lesotho
Libyan Arab Jamahiriya
Madagascar
Mauritius
Mexico
Morocco
Peru
Philippines
Republic of Korea
Romania
Russian Federation
Saudi Arabia
Senegal
Spain
Sri Lanka
Sudan
Switzerland
Syrian Arab Republic
Tunisia
United States of America
Zambia

2. The following intergovernmental organizations were represented at the meeting:

African, Caribbean and Pacific Group of States
European Commission
Organisation for Economic Co-operation and Development
South Centre

[*] For the list of participants, see TD/B/COM.2/EM.14/INF.1.

3. The following United Nations organization was represented at the meeting:

Economic Commission for Africa

4. The following specialized agencies and related organizations were represented at the meeting:

International Monetary Fund
United Nations Industrial Development Organization
World Trade Organization

5. The following non-governmental organizations were represented at the meeting:

General Category

International Confederation of Free Trade Unions
World Association of Small and Medium Enterprises

6. The following special invitee attended the meeting:

Ms. Yoshiko Kurisaki, Geneva

7. The following resource persons attended the meeting:

Mr. Carlos Braga, World Bank, Geneva, Switzerland
Mr. Neil M. Coe, University of Manchester, Manchester, United Kingdom
Mr. Philip Cohen, Chairman, Philip Cohen Consultant, Skelleftea, Sweden
Mr. Mansoor Dailami, World Bank, Washington, United States of America
Mr. Gabor Hunya, The Vienna Institute for International Economic Studies, Vienna, Austria
Mr. Sanjaya Lall, Professor of Economic Development, University of Oxford, Oxford, United Kingdom
Mr. Göran Malmberg, CEO, Zambia Railways, Lusaka, Zambia
Mr. William L. Megginson, University of Oklahoma, Oklahoma, United States of America
Mr. Peter Mihalyi, Professor, Budapest, Hungary
Mr. Michael Mortimore, Economic Commission for Latin America and the Caribbean, Santiago, Chile
Mr. Reg Rumney, Executive Director, The Business Map Foundation, Auckland Park, South Africa
Ms. Cecilia Ugaz, UNRISD, Geneva, Switzerland