BOOK REVIEWS

International Investment for Sustainable Development: Balancing Rights and Rewards

Lyuba Zarsky, editor
(London, Earthscan, 2005), xiv+225 pages

The book is a contribution to the ongoing debate about foreign direct investment (FDI) and its role in development. This debate is characterized, like the general debate about globalization, by a yawning gap between viewpoints, readiness to distort the other side's arguments and exaggerated interpretations of the evidence on both sides. In the case of FDI, its promoters claim that it leads to transfer of technology, increased employment and improved labour and environmental standards, while its critics argue that it entails environmental degradation, exploitation of low-paid workers and human rights abuses. The book reviews recent research and attempts to represent both views - and the supporting evidence - in a balanced way. By and large, it succeeds in doing so, although most of the authors appear to lean more towards the critical side.

The book is divided in two parts: the first deals with the impacts of FDI, particularly the links between FDI, development and sustainability, and the second with the governance of international investment, especially bilateral investment treaties (BITs).

The first part focuses on a review of the evidence, including statistics and case studies, of positive or negative impacts of FDI, particularly as regards economic growth, technology spillovers and environmental performance. The evidence is judged to be inconclusive. This result is not surprising in view of the differences among host countries and industries. It would be more unexpected to learn that there were great similarities between a copper mine in northern Chile, a sock knitting factory in rural China and a foreign affiliate established in Dublin to collect software license income. It appears that the only relationship that can be clearly established is between domestic policies, capacities and institutions in host countries on one hand and results of FDI on the other.

The first part also contains chapters that go into more detail about countries and regions. A review of the experience of FDI in Mexico concludes that the hopes attached to it were not fulfilled, although the author maybe goes a little too far in attributing Mexico's disappointing growth record in the late twentieth century to the effect of FDI. The evidence is circumstantial at best and not very convincing. Another chapter discusses the impact of FDI in sub-Saharan Africa (SSA). This is probably the weakest chapter in the volume. The author concludes, from a review of experiences that is unsystematic and relies on anecdotal evidence, that FDI has made a poor contribution to sustainable development in SSA. He attributes this failure mainly to the lack of "policy coherence" and "poor coordination of institutions". The examples he provides are curious: for instance, he notes that "while environmental laws of most SSA countries contain provisions to regulate FDI, most investment regimes are silent on environmental imperatives". It is not clear how environmental management would be improved by providing regulations in two different pieces of legislation. Neither is it clear why it would be necessary to single out foreign owned firms for special treatment with respect to sustainability. Another chapter deals with sustainable development and FDI in Asia. It makes the point that sustainable development is over-shadowed by "bread and butter issues" in Asia and that FDI "continues to be highly sought after by governments of developing Asian nations, negative environmental and social fallout notwithstanding". As in the case of the chapter on SSA, it is not clear why foreign firms are singled out. The few examples quoted have more to do with general consequences of economic growth and industrialization than with the ownership of industries. In addition, as has been documented over and over again, at least as far as environmental management is concerned, foreign companies do not appear to be worse sinners than domestic ones. If anything, their practices appear to be slightly better.

The second part of the book is by far the more interesting one to anybody who does not take a particular interest in the debate between true believers in either of the two extreme interpretations of the impact of FDI. It deals with the governance of international investment, a subject to which most of us have probably paid less attention than we should have.

One of the chapters concerns BITs. For the uninitiated, it is surprising and somewhat worrying to learn about the lack of transparency associated with the application of these treaties. This is particularly so given that the number of BITs is growing rapidly, in spite of the difficulty in proving any positive effects from them. For instance, it is not clear that countries that conclude such treaties succeed in attracting more FDI than those that do not (although the lack of a real counterfactual makes this conclusion uncertain). The chapter contains a great deal of information on the characteristics of BITs, much of it is of obvious use to anybody dealing - even peripherally - with investment issues. Another chapter undertakes a critical review of investor protection in the North American Free Trade Agreement, and concludes that the investor-state dispute settlement process suffers from a lack of transparency, accountability and legitimacy, a too broad definition of "investors", and overly broad interpretations of host state obligations in areas such as expropriation, non-discrimination and minimum standards of treatment. The third chapter contains a very detailed discussion of the principle of non-discrimination in investment regimes, particularly as applied to environmental regulation. The discussion underlines the complexity of the involved issues, which is rather refreshing after the sweeping generalizations in the first part of the volume. It is perhaps inevitable, although just a little disappointing, that no clear conclusion is reached.

The final chapter of the book provides some hope for those who believe in the potential contribution of FDI to development. It deals with corporate disclosure and transparency, an area where several new initiatives have been taken in the last few years. Among the initiatives mentioned is the Global Reporting Initiative, which has had a major impact on corporate disclosure practices. The chapter advocates the creation of a “Multistakeholder Corporate Governance Framework”. While many would no doubt consider such a framework useful, it is far from certain that it could be negotiated. Those among us with good memories remember the Code of Conduct for Transnational Corporations and how it proved impossible to reach agreement on it. It can be argued that improvements in corporate disclosure can come about without any legal or quasi legal framework and that present trends are encouraging. While self regulation by firms will never solve all problems, it can make a substantive contribution and the possibility of companies with better practices influencing others should not be excluded. This is particularly important when it comes to investments in countries with weak institutions.

Olle Ostensson
Diversification and Natural Resources
United Nations Conference on Trade and Development
Geneva, Switzerland

International Political Risk Management: Looking to the Future

Theodore H. Moran and Gerald T. West, editors
(Washington, D.C., World Bank, 2005), x+251 pages

Political risks still plague international investment. However, some of these risks can be alleviated or managed by way of political risk insurance (PRI). Thus, alongside the growth of foreign direct investment and other forms of cross-border capital flows, a plethora of political risk insurance providers have emerged. Some of these are public entities, like the World Bank's Multilateral Investment Guarantee Agency (MIGA) and the United States government-affiliated Overseas Private Investment Corporation (OPIC). Others, such as XL Insurance, are private companies. This book, the fourth in a series of edited volumes published by the World Bank and based on the MIGA-Georgetown University symposium, presents a truly intriguing insiders' view of how this particular industry works.

The text is divided into four main parts, each consisting of two papers, which are supplemented by a comprehensive overview section written by the editors and an illuminating extract from the discussions among the symposium participants. Throughout the book, conceptual issues are discussed and clarified, and examples of insurance claims and arbitrations are presented and commented on. As readers, we learn that the PRI industry constantly has to evaluate the wording and content of its existing policies in the light of claims experience and more general political and economic developments, so as to ensure that investors obtain the coverage they really need and to limit the number of unreasonable claims. We are also informed about the growing impact of private actors in the industry and the exciting prospects for future public-private cooperation. In short, the editors succeed in making the contributors unveil facts, advances, ideas and opinions from an area of business that is often shrouded in secrecy.

The first part of the book deals with claims and arbitration experiences and the lessons learned from investments that ran into trouble. Kenneth W. Hansen argues that the surge in insurance claims in recent years is largely a result of the "mismatch between the demand and supply sides of the market with respect to scope of coverages" (p. 13). This mismatch is attributed to the conservative bias that bedevils the PRI industry and generally ensures that only three "classic" categories of political risks can be insured against: expropriation; war and political violence; and currency inconvertibility (CI). The problem, however, is that many "new" potentially costly risks – in particular, breach of contract risk and regulatory risk – then remain uncovered by insurance policies that often leave out such risks from the contracts. As a consequence, a wide range of investors fail to obtain the coverage they actually seek and instead have to settle for policies that do not really match their needs. Not surprisingly, therefore, some equity investors and project lenders try to "stretch" the coverage (and many even succeed in doing so), for instance, by claiming expropriation loss when the host government has breached a contract.

This demand-supply mismatch is discussed by other contributors as well. Frederick E. Jenney, for example, contends that investors tend to expect too much from their insurance policies and notes that a breach of contract does not amount to an expropriation "unless it makes impossible the continued operation of the project that is the subject of the contract" (p. 104). Hence, Jenney calls for a clearer insurance policy wording that explicitly and unequivocally excludes breach of contract risk from expropriation coverage. Instead, he contends, the insured should opt for another, lesser-known class of protection, namely arbitral award default coverage. Such a policy ensures that the investor is indemnified by the insurer in case of a breach of contract and subsequent failure by the host government to honour its obligation.

From the empirical point of view at least, the second paper by Robert C. O'Sullivan is the most interesting one. Here, we are treated to an insight into OPIC's cumulative claims history, spanning some 40 years and including nearly 300 political risk insurance claims settlements, all of which are tabulated in a highly informative annex. In many ways, O'Sullivan's text reminds us of the plight of academics in a field of research which lacks, among other things, empirical data on the relative importance of political risk effects, i.e. the events that directly cause losses for transnational corporations. In this respect, the paper is enlightening. We learn, for example, that the pattern of claims has changed over the years. While CI claims predominated over other classes of risks from 1970 to 1990, claims regarding political violence (59% of claims paid) and expropriation (37%) have become much more common in recent years. It is noted that the causal mechanism that accounts for the shrinking significance of CI claims can also explain why incidents of expropriation (broadly defined) are relatively more common nowadays. On the one hand, most developing nations have liberalized their economies, thus refraining from using the exchange control as a policy tool. On the other hand, the opening up of markets also prompt expropriation claims which "arise from the complication that occur when countries open up to foreign investment, make the transition to market economies, and deal with financial crises" (p. 32). Interestingly, the monetary impact also differs between the main classes of risks. Expropriation, which often involves total appropriation of the investment by the host government, usually entails large claims, "whereas inconvertibility claims have usually been for periodic earnings on the insured investment, and political violence claims have typically been for the loss of particular items of tangible property, not destruction of the entire project" (p. 31).

The apparent reduced relevance of CI coverage is also discussed in the paper by Daniel W. Riordan and Edward A. Coppola. Here, focus is placed on the infamous Argentinian debacle and its consequences. The question, simply put, is whether or not CI is still worth insuring against. Allegedly, a number of foreign investors thought that their CI coverages also included protection against a devaluation of the Argentinean peso. Exchange rate changes are, however, typically omitted from CI insurance policies on the grounds that such risks are financial or commercial rather than political.

Riordan and Coppola thus follow other symposium panellists by pointing to the PRI industry's need for conceptual clarification in connection with the drafting of contracts and, not least, the necessity of learning from past and current claims and arbitrations so as to avoid the perennial mismatch between the expectations of buyers and the intentions of sellers of insurance. On this latter score, Tony Heppel, who represents FirstCity Partnership, argues that private PRI providers have a lot to offer in terms of product development and operational flexibility and adaptability. In particular, the growth of private-public joint-ventures in the industry looks promising and can, in the words of Clive Tobin of XL Insurance, "bring real added value into play" (p. 133).

Louis T. Wells' contribution is the only paper that is written by an outsider to the industry. Not surprisingly, therefore, it provides some refreshing views that contribute to broadening the scope of the book. Wells begins by commenting on the discrepancy between the broad title of the symposium and its much narrower contents. Of course, political risk *insurance*, a theme which all but one of the papers focus exclusively on, "is only one element in a program that can enable an international investor to manage political risk" (p. 87). Consequently, Wells brings into his discussion a wide set of property rights protection measures, such as international arbitration provisions, support from the investor's home government, financial backing from external (often politically powerful) institutions and official insurance. The author's main point, however, is that this system of political risk management tools, although in many ways promising, is also worryingly fragile, mainly because it has evolved in a rather piecemeal and uncoordinated fashion. Keeping in mind that some of the papers in this book (including Wells') quite explicitly criticize investors as a group for misunderstanding or deliberately trying to "overstretch" insurance policies, it is perhaps appropriate that Wells also points to the shortcomings of the PRI industry itself. In particular, PRI providers are criticized for actually encouraging moral hazard behaviour and disputes between investors and host country governments. For example, the insurer rarely denies claims from the insured since various agreements "authorize an official insurer ... to turn around and collect its money from the host country if it pays a claim" (p. 96).

In many ways, Wells seems to be taking the side of developing host countries. However, the investors – who constitute a group that profoundly affects the PRI industry – are not represented among the contributors. This is somewhat regrettable, given that most papers dwell in detail on the inconsistency between supply and demand in this industry. The reader is thus left with only one side of the story. In fact, the only contribution from the buyer's side to this volume appears in one of the discussion extracts, where one observer succinctly comments that the PRI industry's main challenge nowadays involves attracting buyers "as many of the traditional clients are surveying their purchases of insurance and wondering if they are being well served" (p. 117).

Notwithstanding the lack of input from the demand side, the book makes for an excellent reading. Even though this is an edited volume, several common threads run through a surprisingly coherent text. The authors seem to agree that the PRI industry needs to learn from their own experience with insurance claims and disputes. Not least, contracts and policies must be meticulously written so as to avoid the misunderstandings and mistakes of the past. In addition, new and/or lesser-known products – e.g., arbitral award coverage, denial of justice coverage, and CI coverage for emerging-market lenders – deserve further attention and development.

Of course, the book should be mandatory reading for any PRI provider. Moreover, foreign investors and project lenders are also strongly advised to read carefully through it, especially given that some of the contributors clearly indicate that large amounts of money are often spent on the "wrong" class of coverage. In particular, however, *International Political Risk Management* should be studied by students and scholars interested in the subject. Unfortunately, political risk analysis has never really taken off as an academic discipline. In part, this is due to severe conceptual confusion and a lack of sound empirical data that link political causes to loss-generating effects for transnational corporations. On both of these scores, the PRI industry in general and this book, in particular, has a lot to offer.

Jo Jakobsen
Department of Sociology and Political Science
Norwegian University of Science and Technology
Trondheim
Norway

New Competition Foreign Direct Investment and Industrial development in China

Guoyong Liang
(Rotterdam, Erasmus Institute of Management,2004),
xiii+325 pages

This comprehensive book examines the competitive influence of foreign direct investment (FDI) on industrial development in China. It also provides policy recommendations in the domain of competition policy at the level of institutional development. This book seeks to fill a gap in research on China in providing deep microeconomic analyses at the industrial level with two industrial case studies - the automotive industry and the electronics/information and communication (ICT) industry - and econometric analysis.

In determining how FDI as a competitive force has influenced the development of industries, three issues are examined: the collusion of transnational corporations (TNCs) and domestic firms to dominate the domestic market due to restrictive government practices and state ownership; the role of the policy environment and its impact on FDI; and the evolution of industries in China. This book, in addressing perceived theoretical gaps in the literature, develops a more dynamic theory on the basis of an eclectic use of theories and tests against a number of Chinese industries.

The first chapter provides a general and extensive background on China's economic development, the role of FDI and China as a transitional economy, providing comparisons with other transition economies and East Asian economies. The second chapter, in defining the key issues, analyses competition and Chinese economic development in terms of market creation, enterprise development, ownership and state-owned enterprises and local economic development. This chapter also highlights the importance of transitional institutions and the building of market supporting institutions. Furthermore, it examines the development of competition policies, and comparisons are made with extant systems in Central and Eastern Europe, Africa, Asia and Latin America. The third and fourth chapters provide a literature review and theoretical underpinning to the central arguments of the book.

The empirical part of the study is divided into three chapters. Chapter five provides background research on FDI across industries as well as competition and industrial development in China. Methodological issues related to case studies are examined. The two case studies relate to the automotive industry and the electronics/ICT industry.

In ascertaining the determinants of market structure in the Chinese automotive industry, a number of hypotheses are tested. Cross-sectional data for the period 1985-2003 were utilized. There are a number of key findings. In the dynamic industrial context of China's passenger car industry, entry order, government support, the degree of foreign ownership and international experience of TNCs determine their achievement in terms of market share. The causal relationship between government policy and the lack of competition is highlighted. Investment scale is not positively related to market share achievement. It can thus be said, from a managerial perspective, early market entry is critical to market share achievement. Local partner selection is crucial, given the nature of strong government intervention. The equity structure is also an important consideration when entering into a joint venture. International operations experience is among the most important determinants of foreign market share. Furthermore, government intervention is seen to have a negative impact by leading firms to make uneconomic decisions. Interestingly, a "light asset" entry strategy is suggested as an optimal choice in terms of entry scale. Investment scale is shown to play an insignificant even negative role in determining market share achievement.

The second case study relates to an econometric analysis of the determinants of innovation in China's electronics/ICT industry, empirically examining the relationship between foreign and domestic firms in terms of R&D spillovers. The determinants relate to firm-level factors (size, profitability, internationalization) and industry-level factors (R&D spillovers from FDI, market structure). Cross-sectional data from the 100 largest firms in China's electronics/ICT industry for 2000, 2001, and 2002 were utilized. The results provide evidence of a positive spillover effect of firm R&D expenditures in China, reflecting the innovation propensity of Chinese firms in the electronics/ICT industry. The association between inward FDI and R&D expenditure is strong. However, any observed association between innovation and FDI needs to be carefully considered before concluding that there is a causal relationship. This case study does not empirically examine the causal relationship and mechanism of the R&D spillover effect. The author notes that this would need to be integrated into the theoretical model for future studies. He also notes that longitudinal research could provide further investigation on the dynamic nature of R&D spillovers.

In concluding, the author highlights a number of factors and makes some important recommendations. He states that the competition regime in China should take into account market imperfections as a result of government intervention and indeed political activities of other countries. He further notes that, at the current stage of China's economic development, there is still a central role for industrial development policy despite the attendant risks for competition policy, and that competition policy be seen as a necessary supplement to industrial policy to ensure that inward FDI play a positive role in promoting industrial, economic and social development. Ultimately, he states that China needs to have a competition policy that takes account of its relative level of development, its specific economic and socio-political context and the long-term objective of sustained economic growth.

This is a very comprehensive book providing a deeper understanding on the impact of FDI on structural change in the automotive and the electronics/ ICT industry in China, and an analysis of the dynamic process though which FDI influences these structural changes. It addresses a number of theoretical gaps and seeks to develop a more dynamic theory on the basis of an eclectic discussion of theories and policy issues. It then uses China's automotive and electronics/ICT industry industries as test case studies for this dynamic model. Its managerial implications are particularly welcome and the role of the Government of China in the potential success of a foreign venture. Whilst this specific study relates to China, to what degree this analysis is transferable to other transitional economies demands further research. The short-comings of this book are more at the level of editing. It is a pity there is no index. The chapters need more synthesising with clearer introductions and conclusions. Apart from these minor points, this is a very constructive contribution to the literature on FDI in China.

John F. Cassidy
School of Business & Law
University College Dublin
Ireland