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FDI from Developing and Transition Economies: Implications for Development

CHAPTER VI
NATIONAL AND INTERNATIONAL POLICIES

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NATIONAL AND INTERNATIONAL POLICIES

Preceding chapters of this *WIR* have shown that the volume, nature and impact of outward FDI are influenced by government policies in various ways. The patterns of FDI today reflect the particular institutional and policy context in which the investing firms have evolved and developed their ownership advantages. Some companies expanded internationally as a safeguard against local market volatility, while others ventured abroad when protection under the import-substitution era came to an end and they became exposed to international competition. In other cases, FDI has been the direct result of active encouragement by the home-country government. Moreover, some large outward investors are State-owned, reflecting the priorities and strategies of their owners.

Corporate decisions are affected by the legal framework governing international capital flows as well as by proactive policy measures to assist companies in their internationalization process. Therefore, there is considerable scope for governments to influence outward FDI, ranging from general policies aimed at creating a competitive business environment in the home (or host) country to specific measures directly concerning FDI.

In a globalizing world economy, accessing international markets, sources of supply and knowledge networks becomes increasingly important. Outward FDI represents one way for a country and its firms to connect with the global production system. Other ways include international trade, licensing, migration and inward FDI. Moreover, the degree to which the home economy can benefit from outward FDI depends not least on the extent of investing firms' commercial and technological links to other economic sectors of the home country (chapter V). Consequently, policies specifically dealing with outward FDI need to be carefully coordinated, not only with other policies aimed at promoting internationalization (through, for example, trade, migration and inward FDI), but also with broader policy areas that may foster growth and upgrading of domestic enterprises. As summarized by one scholar (Dunning 2005, p. 15): "FDI policies are only as effective as are the general macroeconomic and microeconomic policies of which they are part".

However, there is no "one-size-fits-all" policy to apply to outward FDI. While important lessons can be drawn from the experiences of other countries, governments need to tailor their approaches to the specific conditions prevailing in their countries. Policies need to reflect a country's stage of development, comparative advantages, geopolitical position, structure and capabilities of the business sector, and, of course, the government's overall development strategy. As discussed below, there is significant variation in the way countries address outward FDI. Many developing countries have retained restrictions on capital outflows, but there is a trend towards greater openness. In fact, a growing, albeit still small number of developing economies are now implementing active policies to promote outward FDI. Moreover, as countries that have traditionally been capital importers emerge as significant sources of FDI, their emphasis in international investment negotiations may shift, which would have implications for policy-making at bilateral, regional and multilateral levels.

The expansion of FDI from developing and transition economies is also influencing policies in recipient countries. Throughout the world, the newly emerging sources of FDI are attracting increasing attention, raising both expectations and concerns.

This chapter considers the policy implications of outward FDI from developing and transition economies at both national and international level. The analysis draws on the existing literature, a large number of country case studies, and information obtained through UNCTAD surveys of governments, trade promotion organizations and investment promotion agencies. It begins by reviewing the role of home-country governments in promoting the benefits of outward FDI, distinguishing between general and specific policies. The second section focuses on the responses of host economies. The third section turns to implications for international rule making and the fourth section analyses the role of corporate social responsibility in the context of FDI from developing countries. The final section concludes.

A. The role of home-country policies

Policies that aim at furthering the objectives of a home country via FDI are of two kinds: *general* and *specific to outward FDI*, and they require an appropriate institutional framework to support their implementation. General policies cover a wide range of areas that influence the competitiveness of firms, which is not only a basis of sustainable economic development but also a key determinant of outward FDI and its related impacts. Specific policies on outward FDI reflect a government's overall stance on internationalization through FDI; they include measures to restrict, facilitate or promote such investment, as well as to maximize associated benefits. At early stages of development, there may be little attention given to specific policies on outward FDI, but the need for this grows as countries develop. To date, relatively few developing and transition economies have adopted an explicit policy relating to outward FDI, but there are signs that this is changing.

Based on assessments of the likely impact of outward FDI in different industries and activities, a government may design its general and specific policies with a view to fostering FDI that is beneficial to the home economy. Effective implementation of such an approach requires awareness of the evolving corporate strategies and locational determinants of FDI. To the extent that outward FDI contributes to structural transformation of the economy, governments may also need to implement policies that support local firms and individuals in coping with necessary adjustments.

1. Competitiveness policies and outward FDI

Outward FDI may help enhance the competitiveness of firms (chapter V). However, whether active promotion of outward FDI is warranted still deserves careful consideration. Most developing countries have not yet reached a stage at which a proactive approach to outward FDI is feasible or desirable. Instead, for many low-income countries the focus may rather be on the enhancement of domestic firms' capabilities. Thus, specific policies on outward FDI should be positioned within a national strategy aimed at enhancing international competitiveness.

Among the factors affecting national competitiveness, human resources and technological capabilities are fundamental. This means that well-crafted education and science and technology policies are of crucial importance. Firms are the major carriers and creators of national competitiveness, and governments need to create a favourable business environment, with well-functioning factor and product markets, stable economic, social and political conditions, sound legal and regulatory institutions (including tax, regulatory, liability and IPR policies as well as their implementation), and good infrastructure.

Policymakers should ensure that the business climate encourages entrepreneurship and promotes private investment, not just in fixed assets, but also in R&D and training. The lack of a sound business environment may weaken the foundation of the competitiveness of domestic firms. Furthermore, if firms have the capabilities to invest abroad, a poor domestic business climate may even lead them to relocate, thus further weakening national competitiveness. Indeed, in certain circumstances, outward FDI can be a means to escape from the domestic business environment rather than a way to create value for the home economy (chapter IV).

Economic openness can improve welfare and economic performance. The role of economic openness in promoting national competitiveness has been increasingly acknowledged, with most perceived benefits coming from trade, inward FDI and migration (see e.g. *WIR95, WIR01, WIR02*). In the context of developing countries, however, outward FDI as a contributing factor to competitiveness has not yet received much attention (chapter V).

Globalization opens up new channels through which developing countries can enhance their competitiveness, including via outward FDI. However, realizing such opportunities is not easy. It requires appropriate policy responses at both national and international levels. A number of developing-country firms, especially in Asia, have climbed the value chain, internationalized and established competitive positions in a range of industries (chapter III). The fact that four fifths of the top TNCs from the developing world are of Asian (mostly East and South-East Asian) origin partly reflects the effectiveness of industrial policies, based on a competitive and outward-oriented approach, in promoting industrial competitiveness (Amsden 1989, Wade 1990, Johnson 1982, 1995, Woo-Cumings 1999, Lall 2001, UNIDO 2002).[1]

Accordingly, policies on outward FDI may be best positioned within a framework aimed at enhancing industrial competitiveness. Such a framework comprises various key components:

- *SME policy.* Policymakers need to support entrepreneurship and foster the creation of start-up SMEs, especially in knowledge-based industries. In terms of enterprise development, countries can make up for the lack of entrepreneurial talents and start-up candidates through the promotion of new industries and the creation of "seed companies". Spin-offs from public research institutes or from leading universities may also be encouraged (see e.g. *WIR05*), backed by relevant financial institutions.
- *Trade policy.* The role of export promotion in enhancing industrial competitiveness is widely acknowledged. It can be done through various institutional arrangements, for instance, by making customs handling more efficient, establishing EPZs and strengthening the trade infrastructure *(WIR02)*.
- *Inward FDI policy.* Investment liberalization and targeted promotion is important for attracting desired forms of FDI. The challenge is to ensure that foreign affiliates become embedded in the host economy in a way that helps domestic enterprises to develop competitive capabilities (*WIR01*). Export-oriented FDI (*WIR02*) or FDI that helps strengthen infrastructure services (*WIR04*) may be particularly relevant from this perspective.
- *Outward FDI policy*. In general, FDI from a developing country takes place once domestic enterprises have reached a certain level of development. For the majority of developing countries, whose firms and industries are still at an early stage of development, a specific policy on outward FDI may be premature. Instead, a focus on more general policies related to the promotion of industrial competitiveness may be more important.

The role of these policies needs to be defined in the context of a country's overall competitiveness or development strategy. Indeed, by applying policy instruments and institutions in innovative ways, developing countries can try to compensate for their shortcomings as "latecomers" in technology and market sophistication (UNCTAD 2005l). Traditionally, little attention has been paid to policies specifically related to outward FDI. With the rise of TNCs from developing and transition economies it is becoming increasingly relevant to consider the usefulness of such policies, taking due account of the particular situations of different industries and countries.

2. Policies specific to outward FDI

There is increasing recognition that FDI outflows represent one more way of strengthening the competitiveness of firms. However, few developing countries have explicit policies dealing with outward FDI. Some countries have taken major steps in establishing specific organizations to actively support the internationalization of their firms through FDI, but overall, it remains a relatively new area for most governments in developing and transition economies. Concerns related to the risk of capital flight or "hollowing out" have to be weighed against the potential gains that can be achieved through better linkages to global markets and production systems. This section takes stock of these trends and considers possible options available to countries with regard to outward FDI policies.

a. More countries remove barriers to outward FDI

In determining the degree of openness to outward FDI, policymakers have to balance the need for the State to "control" the cross-border flow of capital outflows and the need of firms to internationalize. An excessive and/or non-transparent regulatory burden in the form of foreign exchange controls, approval procedures and reporting requirements may harm the international competitiveness of domestic enterprises. Indeed, excessive red tape and overly stringent exchange controls have been identified as obstacles to the internationalization of firms. Countries have chosen different approaches to deal with this challenge, which reflects varying priorities and economic situations. As of 2005, regulations concerning outward FDI spanned the full spectrum – from outright bans in some countries to full liberalization in others.

Most countries have at some stage exercised control over FDI outflows through various rules and regulations to mitigate potentially negative effects from such investments. In particular, restrictions have been used to avoid adverse effects on the balance of payments. Even most of the developed countries with relatively liberal home economies imposed licensing requirements for outward investment until the 1980s in order to be able to stop certain projects without imposing a total ban on outward FDI. Such restrictions were lifted as the international capital markets became more integrated, and concerns about detrimental effects on balance of payments diminished.[2] Today, Germany,[3] Japan,[4] Poland and the United States[5] retain certain limited controls on such capital flows (IMF 2005b). These typically have a narrow focus on FDI in sensitive activities (arms and ammunition), or are politically motivated.

Among developing countries, restrictions on outward FDI have mainly been used to reduce the risk of capital flight and to secure sufficient access to foreign exchange (see *WIR95*, p. 308). The decision to introduce such controls may not have been intended to restrict outward FDI, even if this was the effect. Exchange controls may have been established to encourage reinvestment by foreign investors in the host country, or in response to crisis situations where the risk of large-scale capital flight might have been apparent. Countries generally become less concerned with controls on capital outflows once they have developed an adequate current-account surplus (box VI.1).[6]

Box VI.1. Controls on international capital flows

Many developed countries have used capital controls in the past, but have largely abandoned them. In developing countries, however, their use remains widespread. This box discusses why there is such a divergence and how these controls relate to outward FDI.

Capital controls are a set of diverse legal and regulatory measures used by national authorities to influence the volume, composition and pattern of international capital flows. They can be direct or market-based (i.e. price-based) in nature. Direct controls limit directly the size of the capital flows to which they are applied through quotas, licensing requirements or outright prohibitions. Market-based controls work on price signals, discouraging capital flows subject to the controls by increasing their cost. Capital controls usually distinguish between different categories of inflows and outflows, and between residents and non-residents, and are generally used in a targeted manner with specific rules for different categories. Controls are often used in various combinations and may be adjusted over time; in some cases they have been utilized only for several months, but in others for a matter of years or even decades. The intensity of restrictions and the extent of their application to different types of flows vary greatly from country to country.

Many developed and developing countries have used capital controls over the past 50 to 100 years. Developed countries, however, generally liberalized capital-account transactions (in the balance of payments) during the 1970s and 1980s, and usually find little need for them today. Developing countries and economies in transition have also moved in the direction of liberalizing such transactions since the late 1980s, but many still retain various controls (Helleiner 1997, p. 9; UNCTAD 2005d). In a number of cases, restrictions on outward FDI have been

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The stringency and nature of restrictions differs by region and country. As of 2005, just over 60% of developing countries applied some form of outward FDI controls, with a lower incidence in Latin America and the Caribbean and Asia and Oceania than in Africa. In South-East Europe and the CIS, companies are commonly required to notify the authorities of FDI transactions.[7] Such notification systems are also applied by several countries for statistical and other purposes. During the past decade, the share of countries exercising controls on outward FDI declined especially in South-East Europe and the CIS and among the new members of the European Union (figure VI.1). In Africa or Asia and Oceania no clear trend in that direction was noticeable, while in Latin America

Box VI.1. Controls on international capital flows (concluded)

maintained. Of the 155 developing economies surveyed by the IMF in 2005 (IMF 2005b), 78 economies (40 in Africa, 23 in Asia and 15 in Latin America and the Caribbean) had restrictive measures. In terms of their nature, 40 were approval requirements combined with various kinds of restrictions (quantitative, sectoral and/ or duty to declare, report, notify or register).[a]

Their wider use by developing countries is related to some characteristics that often distinguish them from developed countries: scarcity of foreign exchange; weaker financial systems and regulations; more common use of fixed exchange rates; and greater vulnerability to internationally and domestically generated economic volatility. In general, developing countries control their capital account (and not only outward FDI transactions) to a much greater extent than developed countries.

The use of capital controls may have various objectives, including to increase economic policy autonomy (especially monetary policy); to facilitate exchange-rate management or support a fixed exchange rate; to promote financial stability (including through prudential regulation) by reducing vulnerability to potentially volatile capital flows or currency speculation; to address an exchange rate or financial crisis; and to discourage certain types of inflows and outflows that are considered undesirable or potentially destabilizing. Common to all these objectives is the focus on supporting the effectiveness of domestic monetary policy, reinforcing exchange-rate management and safeguarding domestic financial stability.

Capital controls are often designed to discourage large short-term inflows (particularly short-term external borrowing) or to reduce capital flight. Many developing countries with binding foreign-exchange gaps often attempt to conserve scarce foreign exchange by limiting capital outflows, (including outward FDI) until this constraint has been overcome. In China, India and the Republic of Korea, for example, controls have been greatly reduced only in recent years, resulting in the proliferation of outward FDI.

Limited empirical research on the effectiveness of capital controls suggests a mixed record. In some cases, they appear to have achieved a degree of success in meeting their aims, although their effectiveness may be compromised over time as economic agents seek to circumvent them (Ariyoshi et al. 2000). They appear to be more effective when supported by broader, sound economic policies.

The use of capital controls also entails potential costs, including the risk of discouraging legitimate and desirable transactions, the administrative costs of enforcement, higher costs of accessing international capital markets, potential for corruption when administrative decisions determine access to foreign exchange, promotion of inefficient or unsound policies if controls are used to sustain inappropriate policies, and the possibility of inhibiting the development of the financial sector and risk-management skills of economic actors.

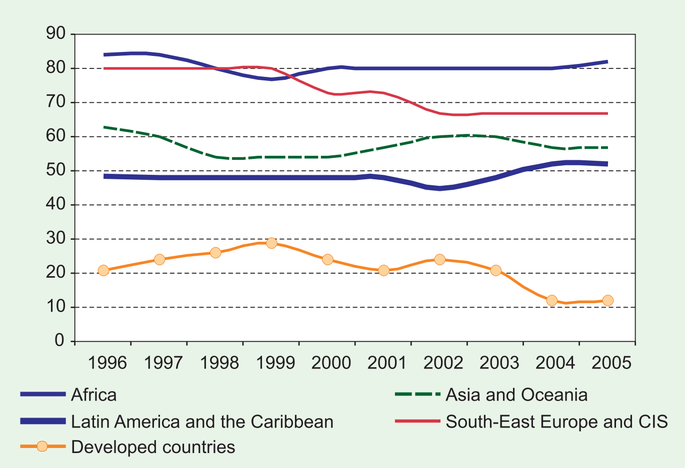
A cost-benefit assessment of capital controls is hard to make. For example, it is difficult to quantify the value of sustaining financial stability, reducing (perhaps avoiding) the impact of a currency crisis or maintaining exchange rate stability. This depends in part on the national priorities of a country. The costs that may arise will depend on specific country conditions and the nature of the controls envisaged. Policymakers therefore need to take into account their specific situation, policy priorities and development strategies when deciding whether to use capital controls and, if so, how to design and implement them.

Source: UNCTAD.

[a] For 32 economies the nature of restrictions was not specified.

Figure VI.1. Share of countries with controls on outward FDI or notification requirements, by region, 1996-2005[a]

(Per cent)



Source: UNCTAD, based on IMF, *Annual Report on Exchange Arrangements and Exchange Restrictions* (from 1996 to 2005), Washington, DC.

[a] To ensure comparability over time, 157 countries for which information was available for the full period 1996-2005 have been included in this figure. Developed countries here include EU-25 for the full period.

and the Caribbean, the percentage of countries using such controls increased somewhat.

It is not possible, on the basis of the information available, to assess the stringency of the controls that are retained by many developing countries. Restrictions may be more or less rigorous, involve a rather straightforward approval system, or apply only to FDI going to particular destinations. Developing countries with considerable outflows of FDI, despite the existence of controls, include Brazil, China, Malaysia, the Philippines, the Republic of Korea and South Africa (box VI.2).

Moreover, a number of countries in Latin America (e.g. Chile, Costa Rica, Mexico) and Asia (e.g. Hong Kong (China), Singapore, the United Arab Emirates) have completely liberalized FDI outflows (table VI.1). Several African countries have also removed their restrictions on outward FDI. Taiwan Province of China was among the first developing economies to initiate a process of dismantling barriers to outward FDI (*WIR95*).[8] Today, overseas direct investors from Taiwan Province of China that require foreign exchange of more than $50 million within one year need approval from the competent authority; for a capital flow of less than that amount, only a post-investment report (within six months) is required. With regard to investments in mainland China, however, an advance application is always required. Other examples of gradual outward FDI liberalization include Singapore – which today has no restrictions on outward FDI – and the Republic of Korea, which still retains some controls (box VI.3). The removal of barriers to capital outflows has been paralleled by increased outward flows from many economies. For example, in the Republic of Korea and Taiwan Province of China, the relaxation of controls led to significant outward investment in the late 1980s (Kumar 1995; *WIR95*, p. 324).

Only a few countries, such as Nepal and Sierra Leone, apply an outright (complete or partial) ban on outward FDI (IMF 2005b). However, more than 40 countries require their firms to obtain an approval, authorization or a licence from their Central Bank or Ministry of Finance before investing abroad. In some cases, approval is based on subjective criteria such as national interests,[9] while in others it depends on the value of a project.[10] In most countries, restrictions on outward FDI apply to all sectors and industries without discrimination. However, there are exceptions. For instance, the Republic of Korea requires prior notification to and approval by the Ministry of Finance and Economy for domestic financial institutions to invest in businesses other than financial and for any resident to invest abroad in banking and insurance.[11]

Finally, with a view to ensuring that FDI brings benefits to the home economy, some countries have imposed requirements upon firms that invest abroad. Serbia and Montenegro and Viet Nam, for example, both require the submission of reports on company activities or operations overseas, financial statements, the repatriation of dividends and profits and payment of taxes on corporate profits.[12]

Whether or not restrictions on outward FDI are efficient, they do little to address the problems related to the possible job losses and structural changes that may result from outward FDI. Little is known about the counterfactuals to outward FDI. Would the enterprises be able to survive and thrive even if they were not allowed to undertake their foreign investments, or would they just become weaker in comparison with those competitors that are allowed to invest abroad? Thus, for countries

Box VI.2. South Africa's outward FDI policy: emphasis on Africa

South Africa is the major source of outward FDI from Africa. The evolution of its post-apartheid policies governing such investment reflects the Government's objective to integrate the country into the region and the world and to play a leading role in regional development.

Over the past decade, South Africa selectively, but progressively, liberalized its outward FDI policies (Rumney 2005, p. 5). Until limits on outward FDI were eventually abolished in October 2004, the Government consistently allowed greater investments into Africa than into other parts of the world (box table VI.2.1). Even after October 2004, firms are required to obtain approval from the South African Reserve Bank. Requests for approval are considered on the basis of the likely impact of their investment abroad on the home economy's balance of payments. The Bank reserves the right to intervene in capital outflows for very large investments in order to manage potential adverse effects on the foreign-exchange market.

The observed involvement of South African State-owned enterprises in infrastructure projects throughout Africa partly reflects the country's commitment to promoting the NEPAD process (chapter III). Eskom, a State-owned energy company, has invested in a number of joint-venture projects in Angola, Botswana, the Democratic Republic of the Congo, Lesotho and Namibia. The national oil company, PetroSA, has interests in Algeria, Gabon and Nigeria, while Transnet, a State-owned enterprise in transportation, has invested in Madagascar, the United Republic of Tanzania and Zambia. These institutions not only provide finance, they also underwrite risk. In addition, the Industrial Development Corporation supports industrial development in the Southern African region by taking up equity stakes in overseas projects. It has equity interest in 89 projects and export finance transactions in 28 African countries (www.idc.co.za). The Development Bank of South Africa is engaged in the financing of infrastructure projects.

Box table VI.2.1. South Africa's gradual easing of restrictions on outward FDI

Year	Change in policy
Pre-1996	Firms were permitted to invest only in Lesotho, Namibia and Swaziland.
1997	Investments of up to 50 million rand were allowed in countries of the Southern African Development Community (SADC) and up to 30 million rand elsewhere.
1998	Limits increased to 250 million rand in SADC and 50 million rand elsewhere, although for approved projects 55 million rand could be invested.
1999	Limits increased to 750 million rand in SADC and 500 million rand in other African countries.
2002	Limits increased to 2 billion rand in Africa and 1 billion rand elsewhere.
Early 2004	Limits increased to 2 billion rand for each new and approved investment into Africa and 500 million rand for investments outside Africa. Consideration was to be given to requests by firms to utilize their local cash holdings to finance up to 20% of the excess costs of the new investment if the overall cost of the investment exceeded the respective limits. The remainder was to be financed through foreign borrowing, the terms of which had to be disclosed to the South African Reserve Bank.
October 2004	Limits on outward FDI were abolished.

Source: UNCTAD, based on IMF 2005b.

Source: UNCTAD.

Table VI.1. Economies with no controls on outward FDI, 2005

Region	Economy
Developed countries	Australia, Austria, Belgium, Canada, Czech Republic, Cyprus, Denmark, Estonia, Finland, France, Greece, Hungary, Iceland, Ireland, Israel, Italy, Luxembourg, Malta, Netherlands, New Zealand, Norway, Portugal, San Marino, Slovakia, Slovenia, Spain, Sweden, Switzerland, United Kingdom.
Africa	Angola, Botswana, Democratic Republic of the Congo, Egypt, Gambia, Kenya, Liberia, Mauritius, Nigeria, Uganda, Zambia.
Latin America and the Caribbean	Antigua, Bolivia, Chile, Costa Rica, Ecuador, El Salvador, Guatemala, Guyana, Haiti, Honduras, Jamaica, Mexico, Nicaragua, Panama, Paraguay, Peru, Trinidad and Tobago, Uruguay, Venezuela.
Asia and Oceania	Brunei Darussalam, Cambodia, Hong Kong (China), Indonesia, Iraq, Jordan, Kuwait, Maldives, Micronesia, Oman, Palau, Qatar, Saudi Arabia, Singapore, Timor-Leste, United Arab Emirates, Yemen.
South-East Europe and CIS	Armenia, Bosnia and Herzegovina, Croatia, Georgia, Kyrgyzstan, Romania.

Source: UNCTAD, based on IMF 2005b.

that have reached a certain level of development, and have domestic firms that could benefit from investing abroad, overly stringent restrictions on outward FDI may be counterproductive. However, there could be a need for policies targeting those groups in society that might be affected as a result of outward investment (section VI.A.3).

b. Active promotion of outward FDI

As highlighted in the previous chapter (section A), FDI can generate various benefits for the home economy. It may lead to an upgrading of jobs and productivity in the TNC's home country that focuses on more advanced activities – more

Box VI.3. The gradual liberalization of outward FDI policies in the Republic of Korea

Outward FDI from the Republic of Korea remained insignificant until the mid-1980s, being originally discouraged by the Government, except for the purpose of securing a stable supply of raw materials or facilitating exports. As the economy developed, the Government's policies on such FDI gradually changed. Four stages can be distinguished in this process.

Stage 1 (1968-1974)

Investing abroad was first permitted in 1968, leading some firms to venture abroad in the early 1970s, mainly in forestry, manufacturing and trading. However, given the concern over chronic current-account deficits the Government maintained various restrictions on outward FDI to mitigate the risk of capital flight.

Stage 2 (1975-1980)

During this period, the Government established guidelines for approval and monitoring of outward FDI. Prior authorization of investment projects was required and strict qualification requirements enforced. Applications for outward FDI projects were approved only for the following purposes: when they were expected to develop and import raw materials which could not be sourced domestically; to relieve bottlenecks in exports; secure a fishery area; or relocate an industry abroad to enable it to regain its international competitiveness.

Stage 3 (1981-1990)

In 1981, the procedure for investing abroad was simplified. Restrictions on investor qualifications were eased and the requirement for prior authorization of investment plans was abolished. However, it was not until 1987 that a liberalization began in earnest. The emergence of a current-account surplus led to an easing of foreign exchange constraints on outward FDI. Moreover, since traditional labour-intensive industries were losing competitiveness due to rising wages and an appreciating currency, relocation of production to lower-cost locations offered one way to cope with increasing competition. The Government established a system whereby firms were allowed to invest abroad in projects of less than $1 million simply by notifying the Bank of Korea. Both the application procedure and investor qualifications were further simplified.

Stage 4 (1991-present)

Despite a current-account deficit in 1991, and the lackluster performance of some outward FDI projects, liberalization continued. In 1994-1995, for projects up to a certain size, outward investors were required simply to obtain a certificate from foreign exchange banks. However, as a prudential measure, a self-financing requirement was introduced in October 1995, but later abolished.[a] From 1996, FDI was permitted in all business categories and the year after, procedures were transferred to the notification (reporting) system for all FDI projects from the authorization (permission) system. Since April 1999, regardless of project size, prior notification to and approval by a foreign exchange bank is the only requirement for overseas investments.[b] With burgeoning foreign exchange reserves and an appreciating currency, the Government has now begun actively to promote outward FDI.

Source: UNCTAD, based on ESCAP 1998, Moon 2005 and information from the Government of the Republic of Korea.

[a] Foreign affiliates with financial assistance of less than $100 million from the parent company were required to finance 10% of that amount. If financial support from the parent company exceeded $100 million, the foreign affiliate was required to raise 20% through self-financing. This requirement was later abolished.

[b] There are some exceptions. Prior notification to and approval by the Ministry of Finance and Economy are required for domestic financial institutions to invest in any other business and for any resident to invest abroad in banking and insurance business, and for investments of more than $10 million by financially vulnerable companies.

capital- and skill-intensive jobs – and typically pay higher salaries. Moreover, it may secure raw material sources and bring in new knowledge and valuable new technologies, both when the outward investment is of a "strategic asset-seeking" type and when there is no explicit motive to access technology: the mere presence in a foreign market is likely to generate various knowledge spillovers back to the home country. Indeed, as noted earlier developing home countries potentially have more to gain from outward FDI, especially in terms of accessing technology. However, certain local capabilities are needed in the investing firm to exploit foreign technologies. Indeed, the level of absorptive capacity in the domestic enterprise sector is an aspect that should influence the extent to which governments engage in active outward FDI promotion.

In general, countries should reach a certain level of development before undertaking outward FDI-enhancing measures. Many of the low-income countries may be well-advised to create a generally more conducive business environment for their firms. This may involve measures such as reducing red tape, improving access to skilled labour, developing the basic infrastructure and improving access to finance. For example, a survey of Chinese investors found that the main impediments to outward expansion were related to limits on foreign exchange, a lengthy application process, limited sources of finance, and costs associated with procedures and regulations (Yao and He 2005).

Several developing countries, mostly in Asia, have not only liberalized their outward FDI policies, but are also actively encouraging their firms to internationalize through FDI. A number of them now view outward FDI as an important vehicle to strengthen the competitiveness of their firms and industries. Similar trends are also apparent in other developing regions.[13] Recent official policy statements indicate that outward FDI promotion has become a priority for some governments, implying that the traditional, cautious attitude towards FDI is changing.

- Singapore declared 2004 as the year of internationalization (UNCTAD 2006, p. 13). The Government has implemented a range of measures to facilitate the international expansion of its public as well as private companies.
- China's "going global" strategy outlined in 2000 is among the most explicit policy initiatives taken by a developing country to boost FDI overseas (box VI.4).
- The Prime Minister of India has specifically stated that: "Our Government will remove all barriers to growth and encourage Indian companies to go global".[14]
- According to the Deputy Prime Minister of Thailand, "It is critical that the broadening and deepening of competitive edge be pursued in multiple dimensions... In the context of Asia, I am referring to the "Pan-Asia super companies"... Some Thai companies are now on the Pan-Asian track, partnering up with multinationals from other Asian countries" (Attapich and Uruyos 2005, p. 27).
- In his budget speech in 2001, South Africa's Minister of Finance recognized: "The global expansion of South African firms holds significant benefits for the economy – expanded market access, increased exports and improved competitiveness".[15]
- The Government of Brazil in 2003 urged its business people to "abandon their fear of becoming multinational businesspersons".[16] Indeed, it has set as a target for the country "to have 10 really transnational companies by the end of President Lula's term of office".[17]

(i) Main instruments used to promote outward FDI

Initial efforts by developing countries to promote internationalization of their firms through FDI may start small and proceed on an incremental basis. A first step may be to dismantle artificial barriers to outward FDI, including relaxing controls and raising financial limits for investments abroad. Once a country decides to use outward FDI as a strategic tool to integrate with global markets and production systems, the next promotional steps are likely to involve measures linked to provision of information, matchmaking and related services. Some governments may also decide to offer certain types of incentives and insurance coverage.

- Dissemination of information on actual or potential investment opportunities via publications, databases, face-to-face contacts and seminars may be particularly relevant for promoting FDI from developing economies with nascent private business support services. Smaller and inexperienced potential investors are likely to benefit most from such support.

Box VI.4. China's "going global" strategy

China's "going global" strategy was envisaged in the mid-1990s and formally adopted in 2000. Today, it is an integral part of the country's overall strategy of economic openness.

The essence of the strategy is to promote the international operations of capable Chinese firms with a view to improving resource allocation and enhancing their international competitiveness. It covers three areas: overseas investment by Chinese firms, overseas construction contracting and international service provision. The Ministry of Commerce (MOFCOM) is responsible for implementing and coordinating the strategy. Another central Government agency involved in the implementation of the strategy is the National Development and Reform Commission (NDRC).

Overseas investment has become the focal point of the "going global" strategy. In recent years, outward FDI has increasingly been encouraged through provision of information about foreign locations, the granting of incentives and a gradual relaxation of foreign exchange controls. A supporting mechanism with the participation of various departments of the central Government is being set up. The Government also facilitates and protects overseas investments of Chinese firms by actively participating in various bilateral and multilateral initiatives.[a]

China's policy on outward FDI has become increasingly formalized in a series of regulations, such as:

- 2004 *Interim Administrative Measures on the Approval of Overseas Investment Projects* (NDRC)
- 2004 *Circular on the Supportive Credit Policy on Key Overseas Investment Projects Encouraged by the State* (NDRC and the Export-Import Bank of China)
- 2005 *Provisions on Issues Concerning the Approval of Overseas Investment and Establishment of Enterprises* (MOFCOM).
- Various other regulations and circulars on foreign currency management, statistics, performance assessment and State-owned asset management.

A selective support policy has been adopted to encourage outward FDI. In October 2004, the NDRC and the Export-Import Bank of China (EIBC) issued a circular to promote (i) resource exploration projects to mitigate the domestic shortage of natural resources, (ii) projects that promote the export of domestic technologies, products, equipment and labour, (iii) overseas R&D centres to utilize internationally advanced technologies, managerial skills and professionals, and (iv) M&As that could enhance the international competitiveness of Chinese enterprises and accelerate their entry into foreign markets. To promote these selected types of FDI the Government offers preferential credit and other incentives.[b]

The "going global" strategy appears to have contributed to the expansion of outward FDI from China. A recent survey conducted by the Asia Pacific Foundation of Canada and the China Council for the Promotion of International Trade found it to be the second most important driving force behind Chinese outward FDI today (Asia Pacific Foundation of Canada 2005). At the same time the effectiveness of the strategy may have been hampered by certain government regulations. For example, in a 2005 survey of Chinese companies, the approval process was found to be unnecessarily complicated, while restrictions on the use of foreign exchange were considered too stringent (Yao and He 2005). The decision by the State Administration of Foreign Exchange to abolish quotas on the purchase of foreign exchange for overseas investment on 1 July 2006 may be an important step in addressing such concerns.[c]

Source: UNCTAD.

[a] As of February 2006, China had concluded BITs with 116 countries and is actively participating in various regional economic integration initiatives.

[b] The EIBC arranges "special loans for overseas investments" through its export credit plan and accelerates the process of project screening. The NDRC works with other agencies to improve the risk control mechanism for overseas investment.

[c] See MOFCOM website (www.mofcom.gov.cn/aarticle/b/bf/200605/20060502256191.html).

- Countries such as Malaysia, Mexico, Republic of Korea,[18] Singapore and Thailand provide *match-making services* that include inviting investors to participate in official missions to targeted countries to find investment opportunities and meet with high-level government officials. The Thai Board of Investment, for example, has set up country desks (dealing with China, Japan, the United

States, Europe and the Association of Southeast Asian Nations) to help interested Thai overseas investors find partners in these host countries.

- Some developing economies offer *training services* to actual and potential outward investors**.** Various *technical services*, such as organizing investment missions, provision of legal assistance, consultancy services and feasibility studies, are also sometimes provided.
- Some countries, including Singapore, the Republic of Korea and Mexico, have created *"comfort zones"* in host countries – a novel approach to facilitate outward FDI. An often-cited case is the China-Singapore Suzhou Industrial Park. The idea was to offer a one-stop point of access to various government ministries as well as Singapore-style education, health and recreation facilities, and an international school. Similar parks were subsequently set up in India and Indonesia.[19] Similarly, to support SMEs' efforts to penetrate IT markets abroad, the Government of the Republic of Korea operates overseas IT support centres ("iParks"), which offer marketing, legal and financial administrative services. The iParks also host seminars on regulations, patents and initial public offerings (IPOs).[20] By December 2005 eight iParks had been established in China, Japan, Singapore, the United Kingdom and the United States, which hosted a total of 67 resident companies.[21]
- *Incentives* can be used to reduce the cost of outward investment projects, and they may also influence a firm's locational as well as operational decisions. They take various forms, including preferential loans, equity finance, export credits and tax incentives. As in the case of incentives used to attract inward FDI, questions about their cost-effectiveness can arise. Incentives can distort the allocation of resources and imply a drain on scarce public resources. Before granting any incentives, countries should seek to assess whether such incentives are warranted in terms of priority and associated costs and benefits. Few such evaluations of outward FDI incentives are available, but a survey in Malaysia found that incentives were of limited importance to the investors that responded (Zainal 2005).[22] A review of the use of various incentives by developing countries that actively promote outward FDI confirms that governments assess the usefulness of incentives in different ways. In general, they are most frequently used by countries in developing Asia (box VI.5) and only rarely in Latin America or Africa.[23]
- *Investment insurance* is increasingly used to facilitate outward FDI. Insurance is provided mainly against political risk, and includes coverage for currency transfer restrictions, expropriation, war and civil disturbance and breach of contract.

Political risk – the risk to a project due to adverse government actions[24] – is becoming a growing concern for TNCs from developing countries, and perceptions of this risk are inhibiting FDI. While developed-country firms have long been aware of how to mitigate such risk, most developing-country TNCs are only just beginning to realize the potential pitfalls from failing to appreciate its importance.

The market for political risk insurance in developing countries is still small. This is because, first, significant South-South FDI is a recent phenomenon, and as a result, demand for political risk insurance from developing-country TNCs has been limited. There has been a general lack of awareness of the product, differing levels of risk perception and cost considerations that have affected demand. Second, on the supply side, the number of public political risk insurance providers in developing countries is limited, compared with developed countries, and there have been few private firms or agencies offering such insurance. Traditionally focusing on trade, export credit agencies (ECAs) in developing countries have not yet fully developed political risk insurance services for investors and their capacity to underwrite is limited.

There are, however, indications that concerns about political risk and awareness of risk mitigators are growing as investors from developing countries seek out business opportunities in other developing countries (box VI.6). This has led to a growing number of developing-country ECAs that offer political risk insurance, and these institutions are aiming to strengthen their programmes. At the end of 2005, there were 17 ECAs based in developing countries that were full members of the Berne Union, the international organization for the export credit and insurance industry. Another 17 agencies based in developing countries are members of the

Box VI.5. Incentives for outward FDI: Asian examples

Singapore offers various grants, loans, tax incentives, and equity financing to promote outward FDI (UNCTAD 2005b). Under its Internationalization Road-mapping Program, a maximum of 70% of the costs of a project of a certain size can be borne by International Enterprise Singapore. Equity financing is provided for overseas expansion that matches 1 Singapore dollar (S$) for every S$2 raised from third-party investors. A double deduction of up to S$200,000 per approval is permitted against the income of approved expenditures incurred in initiating and developing outward FDI. Tax exemption is allowed on 50% of the qualifying overseas income that exceeds a predetermined base.[a] A minimum loan of S$200,000 can help improve companies' access to offshore financing for investment. The Local Enterprise Finance (Overseas) scheme offers a number of fiscal incentives, such as tax exemption for up to 10 years.[b]

Malaysia grants tax exemption on remittances from income earned overseas, and tax deduction for "pre-operating expenses" (Ragayah 1999, p. 470). Investors can also deduct costs incurred in acquiring foreign-owned companies.

As part of its Overseas Investment Policy Package, the *Republic of Korea* has announced that more support will be offered to companies expanding abroad, including via FDI. Measures include an export insurance fund and credit risk cover. In addition, the EXIM Bank provides loans which can cover up to 80% (90% for SMEs) of the funds required for investment projects.

China offers medium- and long-term loans on preferential terms as well as investment insurance (UNCTAD 2005l). It allows foreign investing firms to retain all the foreign exchange they earn within five years of their establishment, after which they pay income tax and submit 20% of their stipulated foreign exchange quota (Giroud 2005, p. 25). The EIBC (Bank of China) and other State-owned banks have played a key role in financing some of the most highly publicized recent deals (Antkiewicz and Whalley 2006).[c] In late 2005, the Ministry of Finance established a special fund to support Chinese enterprises' overseas investments and other international operations by providing direct grants and subsidies for interest payments.[d]

Through its EXIM Bank, *Thailand* grants long-term loans of up to 85% of the cost of construction work to contracting parties in foreign countries who engage Thai firms, and short- to medium-term credit to be used as working capital for work under contract.[e] Long-term credits are available to support Thai investors' overseas investment projects. The EXIM Bank also extends loans for overseas FDI projects and arranges syndicated loans for capital-intensive projects. As part of the so-called Kitchen of the World programme, Thai investors who wish to open Thai restaurants in foreign countries can also benefit from special loans (UNCTAD 2005i).

Source: UNCTAD.

a Its firms can claim capital allowances for approved expenditure on plant and equipment used in overseas subsidiaries.

b Capital losses from the sale of shares can be deducted from the investor's other income, and double deduction of certain expenditures (e.g. feasibility studies, establishment of overseas office) is also allowed. Tax exemption is granted for gains from investment in shares, dividends from foreign investment and interest from convertible loans. Various forms of personal and family support is also given. .

c For example, the EIBC Bank led a group of banks that agreed to lend $6 billion to China's National Petroleum Corporation (CNPC) when it sought a stake in the Russian oil company, Yukos.

d See www.mofcom.gov.cn/aarticle/b/bf/200605/20060502256191.html.

e See www.exim.go.th, accessed in April 2006.

Prague Club, an informal network for agencies that do not yet meet the membership requirements for the Berne Union.[25] In addition, foreign private providers and brokers of political risk insurance are increasingly looking to enter countries where the insurance industry is being deregulated.

(ii) Agencies promoting outward FDI

Countries differ considerably in their institutional set-up for implementing policies aimed at promoting outward FDI. While most developing countries do not have designated agencies for this purpose, a few governments have created various

Box VI.6. Political risk insurance as a tool for promoting South-South investment

Political risk insurance is becoming better known in the developing world as a risk mitigation tool. Developing-country TNCs are improving their management expertise and access to a variety of financial and risk management tools that help them capitalize on growth opportunities in developing and transition economies. The experience of Investcom Holding LLC (Investcom) offers an insight into how companies from developing countries may use political risk insurance to seize growth opportunities in operating environments that may be perceived by other investors as too challenging.

Investcom is a telecommunications company based in Lebanon. It recently merged with MTN Group Ltd. (South Africa). The company's portfolio of investments now spans underserved markets in countries such as Afghanistan, Guinea and Yemen. Its key advantage is its knowledge of working in environments seen by United States or European telecom companies as being too difficult, risky or remote. During the civil war in Lebanon, Investcom learnt some valuable lessons, which made it better equipped to invest in what were perceived as high-risk places.

Risk mitigation and access to financing have been critical to the management of its investments in difficult environments. The company has used political risk insurance not only to manage its non-operational risks but also to obtain the needed finance. It has partnered with MIGA – a World Bank institution that provides political risk insurance for the private sector – for three of its investments in West Asia and Africa.

It is a major benefit of political risk insurance that it can be used as collateral to obtain bank loans. In the case of Investcom, while the company would have contemplated taking political risk insurance in the countries it was planning to invest in, the fact that it could leverage the guarantee to obtain funds from banks was the deciding factor.

Source: MIGA.

bodies that specialize in providing different support to firms wishing to invest/expand abroad. Singapore stands out with the most sophisticated set of such policies that are integrated into broader efforts to promote competitiveness (box VI.7). Active promotion of outward FDI involves a series of policy instruments and agencies – public as well as private (box VI.8). The most important public bodies in this respect include: trade promotion agencies, investment promotion agencies (IPAs) and export credit and insurance agencies.

As exports and FDI represent alternative ways of serving foreign markets, some countries have added outward FDI promotion to the tasks of their *trade promotion organizations* (TPOs). An UNCTAD survey of TPOs conducted in early 2006 found that this is relatively common in developed countries (table VI.2). It also found that a number of developing and transition economies – including Brazil, Georgia, Jamaica, Kenya, Morocco, Oman and Singapore – are adopting a similar approach, and several others are planning to do so. While the nature of the support offered by TPOs for outward FDI promotion differs, market information and match-making services of some kind are the most commonly offered (table VI.3).

In some developing countries, *investment promotion agencies* (IPAs) responsible for attracting *inward* FDI, like some TPOs, have also become involved in the promotion of *outward* FDI, such as the Economic Development Board (EDB) in Singapore (box VI.5), the Foreign Investment Agency of Viet Nam, and the Malaysian Industrial Development Authority (MIDA).

Another key agency deployed by developing countries to increase their outward FDI is a specialized ECA, such as an *Export-Import (EXIM) bank* or other financial institution that can provide insurance cover and extend credit to overseas investors. Such agencies typically provide short-term export credit insurance and credit facilities (such as letters of credit) as well as medium- and long-term insurance, credit and guarantee programmes that are similar to those provided by their private-sector counterparts in advanced countries. In some countries, such as Malaysia, Thailand[26] and Turkey, the EXIM Bank is a key agency for the promotion of outward FDI. The EXIM Bank in Malaysia, for example, explicitly supports Malaysian companies, especially those in labour-intensive industries, to relocate to countries where labour is cheaper (box VI.9). The

Box VI.7. Singapore's outward FDI promotion strategy

Until the mid-1990s, FDI from Singapore was relatively insignificant, heavily concentrated in adjacent Malaysia, and focused on the manufacturing and financial services sectors. To promote outward FDI, in 1994 the Government introduced a regionalization strategy with two distinct objectives: to facilitate FDI by Singaporean enterprises and to transform Singapore into a regional headquarters for TNCs operating in Asia. The strategy sought to consolidate Singapore's comparative advantages in the region, attract high value-added industries to Singapore, and develop the international competitiveness of Singaporean firms. The three main agencies directly involved are: International Enterprise Singapore (IE Singapore), the Economic Development Board (EDB) and the Standards, Productivity and Innovation Board (SPRING). In addition, government-linked companies (GLCs) have assumed an important role.

IE Singapore's mission is to help Singapore-based enterprises grow and internationalize successfully. In Singapore as well as in 37 overseas centres it provides various services, including market information and assistance in building up business capabilities and in finding overseas partners. Its Regionalization Finance Scheme assists local SMEs to set up overseas operations and offers fixed rate loans for acquiring fixed assets for overseas projects. These overseas operations must complement the activities of the Singapore operations and result in economic spin-offs for Singapore. The Overseas Investment Incentive of IE Singapore provides a three-year support programme to encourage local companies to make overseas investments that will generate benefits for Singapore, such as the enhancement of operations in Singapore, and the creation or acquisition of new markets overseas that will increase production and export sales and services of companies from Singapore. The Enterprise Fund can also help find customized financial solutions to overseas investors.

The *EDB* was established in 1961 as a one-stop IPA to assist foreign firms in their operations in Singapore. While its main focus is still inward FDI, since 1993 the agency has a division specifically for promoting the regionalization of Singaporean firms. Among other things, it offers an Approved Foreign Loan Incentive to help improve companies' access to offshore financing. The Expansion Incentive for Partnerships provides tax exemption on 50% of the qualifying overseas income with a view to assisting Singaporean companies in establishing competence and conducting regional activities. The EDB also has an investment arm that acts as the "visible hand" of the Government for promoting productivity, innovativeness and competitiveness of local companies.

SPRING's mission is to enhance the competitiveness of local enterprises, particularly SMEs. It nurtures a pro-business environment that encourages enterprise formation and growth, facilitates the growth of industries, enhances productivity, innovation and capabilities of enterprises, and helps improve access to markets and business opportunities.

There is generally no restriction on using financial support from IE Singapore, EDB and SPRING for overseas operations or market expansion, as long as the core and highest value activities remain in Singapore.

Source: UNCTAD, based on Toh 2006 and UNCTAD 2005b.

Table VI.2. TPOs and outward FDI promotion: results from a survey

Region	TPOs that promote exports and outward FDI	TPOs that promote exports and that *are planning* to start promoting outward FDI	TPOs that promote exports and that *do not plan* to promote outward FDI
Developed countries	Austria, France, Hungary, Italy, Japan, Norway, Slovenia, Spain (Catalonia)	Czech Republic, Lithuania	Latvia, Malta, United Kingdom
Developing economies	Brazil, Jamaica, Kenya, Morocco, Oman, Singapore	Belize, Botswana, Fiji, Mongolia, United Republic of Tanzania	Argentina, Chile, Cook Islands, Cuba, Dominica, Hong Kong (China), Mozambique, Nepal, Turkey
South-East Europe and CIS	Georgia	Bulgaria	Croatia, Serbia and Montenegro

Source: UNCTAD survey of TPOs, January-March 2006.

Box VI.8. Private sector assistance to overseas investment - some examples

In some countries, such as India, Malaysia (box VI.9), South Africa, Thailand, Turkey and Viet Nam, there are instances of the private sector (e.g. business councils, business consortia and chambers of commerce) offering relevant services.

- The Federation of Indian Chambers of Commerce helps Indian businesses improve their competitiveness and enhance their global reach through research, interactions at the highest political level and global networking. India's Joint Business Councils have also opened up business opportunities abroad. Such councils have been established in over 69 countries, including Australia, China, Japan, the Republic of Korea and the United States. The Councils meet regularly to promote two-way trade and investment.
- The South African Institute of International Affairs publishes an annual *Business in Africa Report*, which tracks the experiences of companies' investments in Africa and provides policy recommendations. The Chambers of Commerce and Industry in South Africa also help in facilitating business opportunities and activities in a regional context and further afield.[a]
- In Thailand, the Federation of Thai Industries and the Thailand Board of Trade have recently become active in promoting Thai businesses abroad (Brimble and Sibunruang 2005, p. 13).
- In Turkey, Bilateral Business Councils offer information, organize meetings and provide various financial support to outward investors (Erdilek 2005, p. 15).
- The Viet Nam Chamber of Commerce and Industry offers various programmes including a comprehensive support services for foreign investment missions.

Source: UNCTAD.
[a] See www.saiia.org.za and www.chamsa.org.za/policy.html.

EXIM Bank in Turkey, contributed to the initial wave of Turkish FDI into the Balkans, the Russian Federation and Central Asia (Erdilek 2005, p. 14). In India, the EXIM Bank originally proposed the creation of an automatic approval system, and has since supported over 120 ventures in more than 40 countries (Subramanian 2005).

Relatively little is known about the effectiveness of individual policy instruments, as there have been few serious evaluations. However, all promotional measures involve costs of some kind. Every country therefore needs to determine the optimal level and form of support to outward FDI in the context of its particular situation. The

Table VI.3. Services offered by TPOs promoting outward FDI

Economy	Information provision	Match-making services	Incentives	Feasibility studies	Legal support	Support to training	Investment guarantees
Austria	X	X	X	X	X		
France	X	X		X	X		
Hungary	X	X		X			
Italy	X	X	X	X	X	X	
Japan	X	X		X	X	X	
Norway	X	X	X	X		X	
Slovenia	X	X		X	X	X	
Spain (Catalonia)	X	X	X	X	X	X	
Brazil	X	X					
Jamaica	X	X	X				X
Kenya	X	X		X		X	
Morocco	X	X					
Oman	X	X			X	X	X
Singapore	X	X	X	X	X	X	
Georgia	X	X		X			

Source: UNCTAD survey of TPOs, January-March 2006.
Note: Based on responses from those TPOs that stated that they promote outward FDI.

Box VI.9. Malaysia's approach to outward FDI promotion

Malaysia has a range of agencies involved in the promotion of competitiveness in general and outward FDI in particular. The institutions involved in facilitating overseas investment are the EXIM Bank, the Malaysian Export Credit Insurance Berhad (MECIB); the Malaysian South-South Association (MASSA); as well as such institutions under the Ministry of International Trade and Industry (MITI), such as the Malaysia External Trade Development Corporation (MATRADE) and the Small and Medium Industries Development Corporation (SMIDEC).

The primary responsibility lies with the EXIM Bank. It provides financial and advisory services to Malaysian overseas investors. Financial support is granted through four kinds of facilities:

- The Overseas Project Financing Facility supports Malaysian investors undertaking projects overseas (e.g. in manufacturing, infrastructure and other developmental projects);
- The Supplier Credit Facility aims to boost Malaysian exports to international markets;
- The Export Service Facility supports Malaysian companies involved in providing consultancy services in foreign countries in selected areas;
- The Export Credit Refinancing Scheme offers competitive interest rates and guarantees to lenders involved in high-value capital goods and service activities.

MECIB provides export credit insurance services to Malaysian corporations for exports as well as for their investments abroad. For example, its Overseas Investment Insurance assists Malaysian companies in protecting their overseas investments and profits against transfer restrictions, expropriation, war and civil disturbances, and breach of contract.

Specific attention is given to South-South relations. For example, *MASSA* aims to promote bilateral trade and investment ties with other developing countries, through such activities as organizing business forums/dialogue sessions, fact-finding, trade and investment missions abroad to developing countries, and information related to trade and investment opportunities in developing countries. MASSA's investment arm, *MASSCORP* is a consortium of 85 Malaysian firms from various industries that, among other things, also promotes overseas investment by Malaysian companies.

SMIDEC encourages SMEs to engage with the international economy through cross-border investments. It offers three main services: (i) the Funds for Cross-Border Investment in Manufacturing programme, which was designed to facilitate relocation or expansion of Malaysian SMEs' operations abroad;[a] (ii) overseas investment facilities (export credit insurance and gurantees); and (iii) the Malaysia-Singapore Third Country Business Development Fund, which assists firms from the two countries in identifying business opportunities in other countries, especially in South-East Asia. This Fund can also underwrite costs involved in conducting feasibility studies, commissioning market or business research, and organizing joint missions.

These three programmes are backed by other forms of institutional support, such as investment guarantee agreements negotiated between Malaysia and 64 other countries. These agreements cover insurance against non-commercial risks such as expropriation and they guarantee remittance of currency and profits – an area of major concern to potential investors abroad.

All the above programmes are backed by a network of offices abroad, operated by the MITI, which are able to offer Malaysian firms venturing abroad with various services. Firms can also receive various financial and tax incentives for cross-border investment, including tax relief on income earned outside Malaysia, tax deductions for pre-operating expenses, and incentives for acquisition of foreign-owned companies.

Source: UNCTAD, based on Zainal 2005.

[a] By end 2005, eight approvals had been granted to companies under this scheme, with funding of 54.6 million ringgit ($14.4 million), mainly for expansion to lower-cost locations within the ASEAN region.

impact of outward FDI depends in part on the specific capabilities of the domestic enterprises: the stronger they are, the more likely that benefits to overseas investors will generate spillovers to other domestic companies and institutions. For the same reason, it may make sense for a government to concentrate (target) its support to industries and activities in which the home country is particularly strong. The initiative by the Republic of Korea to set up iParks, targeting IT firms in particular, illustrates this point. Meanwhile, special attention may be needed to support SMEs by providing them with appropriate information, and helping them find partners or investment opportunities.

c. Home-country measures to promote South-South FDI

From the perspective of facilitating more FDI, technology and related financial flows to developing countries, increased FDI from developing countries implies new opportunities for "South-South" cooperation. As noted in chapter III, for many low-income countries, FDI from other developing countries accounts for the bulk of the capital they receive. This is partly linked to the nature of the ownership-specific advantages of the TNCs involved (chapter IV), which sometimes give them a competitive edge over developed-country rivals when entering a particular host economy. This may be particularly true of intraregional South-South investment, where developing-country TNCs may benefit from close geographic and cultural proximity to the destination. But there is also scope for policymakers to be proactive in encouraging South-South investment.

This point was recognized at the Second Summit of the Group of 77 held in Doha, Qatar in June 2005, where investment was identified as one area of enhanced collaboration. To further explore opportunities for such collaboration, the Plan of Action of the Summit, called on the Chairman of the Group of 77, with the support of UNCTAD and the Special Unit for South-South Cooperation, to

> "organize periodically a forum on investments among the countries of the South, for discussion and the publication of successful experiences among developing countries in that field…" (para. 88).

A number of developing countries are already explicitly promoting South-South FDI. In South Africa, the Government grants special treatment to FDI going to the Southern African region, and encourages its State-owned enterprises (e.g. Transnet and Eskom) to invest in infrastructure in that region (box VI.2).[27] These and other investments in the African region are supported by institutions such as the Development Bank of Southern Africa and the Industrial Development Corporation of South Africa.

During the 1978-1992 period, India accorded special treatment to investments going to other developing economies (UNCTAD 2005i). Singapore has launched various programmes, including Regionalization 2000, aimed at encouraging intraregional FDI by Singaporean companies (UNCTAD 2005b). In Malaysia, the Malaysian South-South Corporation Berhad (MASSCORP) promotes bilateral trade and investment ties between countries in the South by serving as a platform and link between Malaysian businesses and other developing countries (box VI.9, Zainal 2005).[28] Intraregional South-South FDI is also promoted through various regional integration schemes (discussed in section C below). While most South-South FDI is intraregional in nature, some Asian countries have adopted measures to promote interregional investment, particularly between Asia and Africa (see, for example, World Bank 2004, pp. 69-70).

There are also international organizations that provide political risk insurance to support South-South FDI. Key among these is the Multilateral Investment Guarantee Agency (MIGA), which has witnessed an increase in its coverage of South-South investments. In fiscal year 2000, MIGA supported six South-South projects, while in 2006, the agency issued guarantees worth more than $291 million for 15 such projects. The bulk of the South-South investments originated from companies in middle-income countries, for example, a Malaysian firm investing in a housing project in Ghana, and an Egyptian firm investing in the telecommunications industry in Bangladesh. Moreover, half of the investors investing in developing countries were from the same region or geographically close, such as a South African firm investing in Uganda, or a Colombian firm investing in Ecuador. MIGA also increases insurance capacity and expertise in developing countries through its work with local export credit agencies (box VI.10).

UNCTAD has been making efforts to enable the sharing of experiences among various institutions that can financially support South-

South trade and investment. Its proposal for the creation of a network of EXIM banks and development finance institutions (DFIs) was endorsed at the Doha High Level Forum on Trade and Investment in December 2004, and the first meeting of the Global Network of Export-Import Banks and Development Finance Institutions (G-NEXID) was held in Geneva in March 2006.[29] G-NEXID is intended to boost agreements between developing-country EXIM banks and DFIs to reduce costs of trade between the world's poorer nations. It will spur cross-border investment, make financing more readily available to new and innovative businesses and enable the growth of niche markets. The network will allow developing countries to learn from each other about effective practices for entering new markets, the financing of non-traditional goods and services, and risk-sharing methods for investments.[30]

Box VI.10. MIGA's assistance to export credit agencies

MIGA uses a range of reinsurance and co-insurance products with ECAs, partnering with them to leverage each others' guarantee capacities and to manage better the risk profiles of their portfolios. MIGA's partnership encourages other insurers to participate in projects they might otherwise avoid insuring and to venture into frontier markets. Insurers partnering with MIGA benefit from the agency's expertise in risk analysis, claims management and recoveries. Through facultative reinsurance and its cooperative underwriting programmes, MIGA can form syndicates of private and public sector insurers in order to be able to support projects that exceed their individual capacity. With respect to South-South investments, in recent years it has entered into a number of agreements and partnerships with agencies such as Islamic Corporations for the Insurance of Investment and Export Credit, Export-Import Bank of Thailand and the Export Credit Guarantee Agency of India.

MIGA also provides technical assistance and training to developing and transition economies' ECAs through seminars and training sessions. It has co-hosted with the Slovene Export Corporation a seminar for Central and Eastern European agencies, and conducted training seminars for the staff of Sinosure, the Chinese ECA, and local banks in China.

Source: MIGA.

3. Mitigating potential risks associated with outward FDI

Even in countries that have gone far in liberalizing outward FDI, there are concerns related to the ultimate impact on the home economy (chapter V). Potential risks for the home economy may include export of jobs, hollowing out and balance-of-payments problems. The expected effects depend on the motives for investing abroad, the conditions in the home economy and the relative position of the home country's industrial sectors in global value chains. Most importantly, if the home country does not provide competitive conditions for production, TNCs may decide to relocate the most attractive jobs to other countries. Thus, policies aimed at creating a favourable business environment in the home country may be the best way to secure benefits from outward FDI.

However, the increase in outward FDI may result in a loss of policy autonomy of the national government, since TNCs may make reasonably credible threats to move production if they find national economic policies not conducive to their requirements. Indeed, possibilities of using transfer pricing to shift profits (and tax revenue) out of the home country may be strong enough to compel a government to adjust its policies. Moreover, competition between different countries may result in industries being subject to only a minimum set of requirements, and costs if financing the public sector, for example, may increasingly have to be borne by the less mobile tax base – consumers and wage earners rather than firms and capital owners.

There are various options at hand for countries to address possible negative effects from outward FDI. Home-country policies might be used to neutralize or alleviate the potential negative effects of the investment. For example, one concern in middle-income developing countries is that FDI aimed at seeking out lower-cost locations will have negative effects on their domestic unskilled labour. In the Republic of Korea and in Turkey (Erdilek 2005), the search for lower production costs has indeed been a motive for overseas investments (chapter IV). In this process, low-paid jobs are shifted offshore, and the jobs that remain at home typically are those that require higher skills. It may be desirable, or even necessary, to introduce policies targeting those groups in society that may lose out in this process. Adult education and training programmes, as well as programmes to encourage SME development are examples of policy responses that support adjustments without obstructing the internationalization process.

In the Republic of Korea, the Government has adopted several measures to counter the risk of industrial hollowing out. First, to balance or complement outward FDI by its firms, the Government actively promotes inward FDI, especially for its high-tech industries. Second, particular attention is given to supporting domestic industries that produce parts and materials for export to Korean firms that have shifted some production abroad. In this way, the Government aims at increasing trade surpluses through intra-firm trade between foreign affiliates and their domestic parent companies; its support to technological development in strategic parts and materials is one example (Republic of Korea, MOCIE 2003). Third, concerted efforts are being made to expand and develop future growth industries. The Government has selected 10 such industries and sources of technology with the aim of acquiring and developing world-class technologies and products in certain fields by focusing on the development of new technologies in high growth industries.[31]

B. Implications for host-country policies

Increased FDI from developing and transition economies also has implications for recipient countries. First, a larger number of sources of FDI implies a more diverse set of countries for investment promotion agencies (IPAs) to target. For many low-income countries, South-South FDI already accounts for a large share of their inflows (chapter III); this pattern may be accentuated in the future. More potential sources of FDI may also provide individual governments in developing host countries with greater bargaining power in their relations with TNCs from developed countries (Gelb 2005). The growth of South-North FDI is also generating various responses in developed countries. On the one hand, some countries are taking active steps to present themselves as attractive locations for investments by TNCs based in developing and transition economies. On the other hand, some stakeholders view the entry of new competitors as an unwelcome development, and are proposing various protective measures, especially when the TNCs have entered, or tried to enter, developed markets through M&As.

1. Host-country policies for maximizing the benefits from South-South FDI

Given the possible effects of South-South FDI on recipient countries (discussed in chapter V), what kinds of policies would enable developing host countries to maximize the net benefits? Should FDI from developing and transition economies be addressed in a different way than FDI from developed countries, and if so why?

Given the diversity in terms of levels of development, economic structure, industrial specialization and geographic location of host and home developing and transition economies in the universe of FDI, any discussion on the role of host-country policies needs to remain at a relatively general level. Policies appropriate to an LDC are likely to differ from those warranted in a middle-income country, because each will attract different kinds of FDI, and because they are likely to have very different levels of sophistication of their legal and institutional frameworks as well as the absorptive capacity of their local enterprises. It may still be useful to consider what policy areas are particularly relevant in this context.

In principle, to benefit from inward FDI from developing and transition economies, policies should not differ significantly from those applied to FDI from developed countries. Thus, the same basic policy instruments can be used to attract, benefit from and mitigate costs associated with inward FDI, regardless of whether it is from developed countries or from developing or transition economies.

An important starting point for designing policies to optimize the benefits from inward FDI is to have a basic understanding of a country's comparative advantage and development objectives. This helps in assessing what kind of FDI can realistically be attracted as well as the possible consequences of potential inflows (*WIR02)*. As noted in chapter III, low-income countries are relatively more dependent on FDI from other developing countries, possibly indicating that such investments are easier to attract at an early stage of development. Moreover, a large proportion of these flows is often intraregional in nature. In terms of an investment promotion strategy, it may therefore be rational for low-income countries to pay particular attention to investors originating from other developing countries within their own region.[32] Regional cooperation can be one element of such a strategy (see section C below).

In terms of enhancing the positive impact of inward FDI, host-country governments need to consider the full range of policies that can influence the behaviour of foreign affiliates, and their interaction with the local business environment. This requires taking into account the specific characteristics of different industries and activities.

Investment policy will need to consider the economy's unique circumstances in terms of its endowments, potential and prospects, preferably compared with alternative locations. For developing countries that are highly dependent on natural resources, investment diversification is often an important objective of investment policies. This may lead governments to give strategic emphasis to manufacturing activities, while considering how FDI from developing and transition economies can contribute to such diversification. Focus may be placed on labour-intensive and resource-based processing, as well as export-oriented production in relatively low-technology manufacturing. Investor targeting, in this context, requires identification of the main players in the relevant industries and of their corporate strategies.

But FDI alone cannot ensure the development of productive capabilities; it is important to pay attention to the amount and quality of backward linkages between foreign affiliates and domestic firms. Such linkages represent an important channel through which intangible and tangible assets can be passed on to domestic enterprises. Host-country governments can introduce various measures to encourage linkages between domestic suppliers and foreign affiliates and strengthen the likelihood of spillovers in the areas of information, technology and training (*WIR01*).

2. More FDI sources for IPAs to target

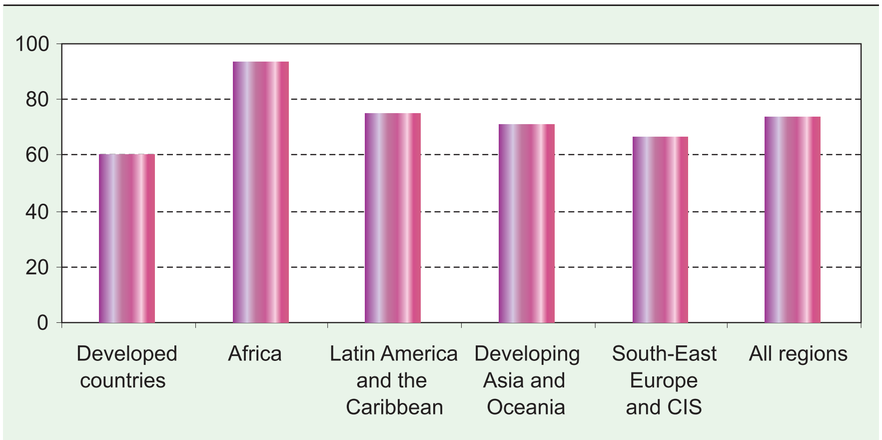
Various studies have concluded that lack of information on investment opportunities and knowledge of foreign cultures can be major obstacles to the overseas expansion of firms from emerging economies, especially SMEs (UNCTAD 2005l). The activities of IPAs in host economies can help bridge the information gap, and provide assistance to prospective investors.

Both developed and developing countries are already actively seeking to attract FDI from developing and transition economies. An UNCTAD survey conducted in February-March 2006 among members of the World Association of Investment Promotion Agencies (WAIPA) shows that IPAs attach importance to these relatively new sources of investment. In fact, out of the 68 responses, 50 IPAs (74%) stated that they target FDI from developing or transition economies (figure VI.2). The survey results confirm that developing countries attach particular importance to FDI from the South. For example, 94% of the African respondents target FDI from developing countries. However, even as many as 60% of developed-country IPAs participating in the survey also target such FDI.

The most favoured target is China, mentioned by 72% of all IPAs that target FDI from developing or transition economies (figure VI.3), followed by India, Malaysia, the Republic of Korea and South Africa in that order.[33] Among developed-country IPAs, China was the most commonly mentioned target source, followed by such other Asian economies as India, the Republic of Korea, Singapore and Taiwan Province of China. In the case of IPAs based in developing and transition economies, China and India remain in the first two positions, followed by Malaysia, South Africa and the Republic of Korea. Thus Malaysian and South African investors are relatively more important targets for IPAs in the South than for IPAs in the North. The opposite is true for FDI from Singapore and Taiwan Province of China.

Confirming the importance of intraregional South-South FDI, there are distinct regional variations in IPA targeting. Among the developing Asian agencies, almost all (97%) the targets mentioned are also in Asia. Similarly, in the case of respondents from Latin America and the Caribbean, two thirds of the targets indicated are in Latin America and the Caribbean (figure VI.4). And while for African IPAs, developing Asia was reported to be the most favoured target region (68%), a considerably higher share (31%) than for IPAs in other regions of the target countries were in Africa. In fact, the most often mentioned target economies by IPAs in the developing world were consistently a country within their own region. For African IPAs, South Africa tops the list, while in Latin America and the Caribbean, Brazil is the most targeted source country.

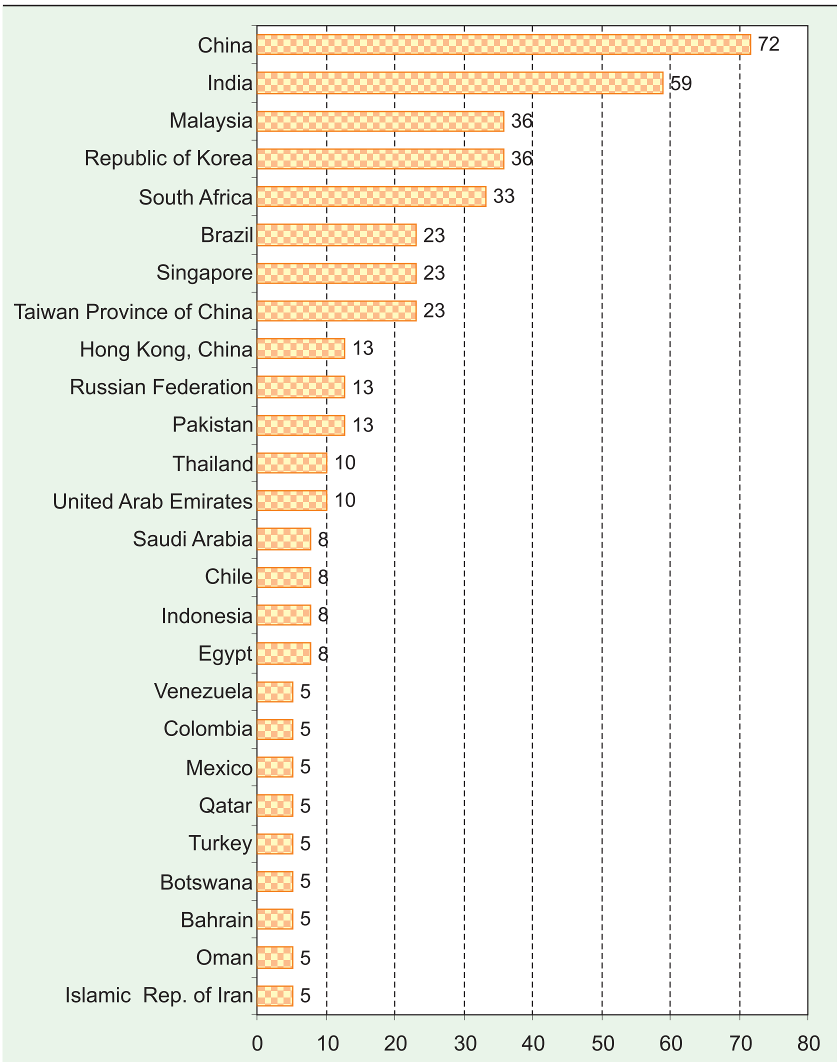
Figure VI.2. Percentage of IPAs that target FDI from developing or transition economies, by region of IPAs



Source: UNCTAD Survey of IPAs, February-March 2006.

Figure VI.3. Developing and transition economies targeted by IPAs as potential sources of FDI

(Percentage of IPAs)



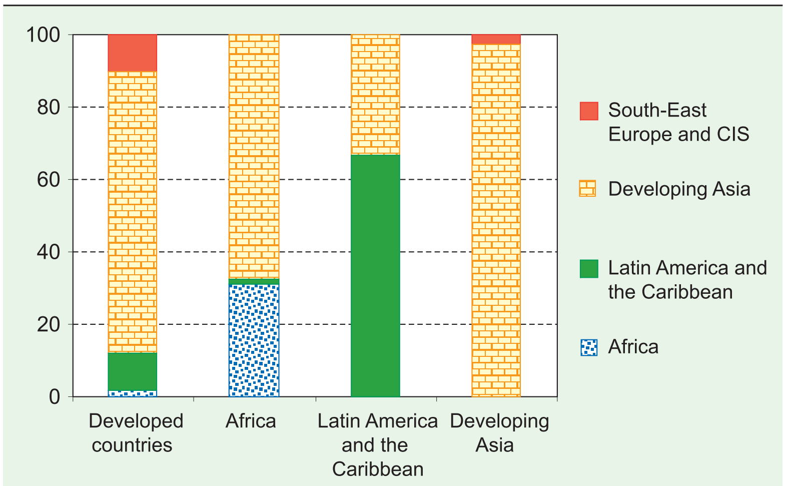
Source: UNCTAD Survey of IPAs, February-March 2006.

A number of IPAs have set up offices in selected developing and transition economies to attract FDI. About 40% of developed-country IPAs have at least one such office, while the share of IPAs from developing countries is lower, ranging from 17% among IPAs in transition economies to 25% for those in Latin America and the Caribbean. Among those IPAs that have offices in developing or transition economies, China has so far been the preferred choice by both developed- and developing-country IPAs. Other relatively popular sites include India, the Republic of Korea and Singapore (table VI.4).

Of all respondents, 41% stated that they target FDI from developing and transition economies in particular industries, the main targets being tourism (mentioned by 50% of the 28 IPAs that target specific industries), followed by textiles and leather (46%), agriculture, forestry and fisheries (43%), information and communication technology (ICT) (36%) and electronics and electrical equipment (29%) (figure VI.5). Due to the small number of respondents, only a tentative picture can be drawn with regard to regional priorities. Developed-country IPAs seem to give priority to the ICT industry, African IPAs focus on FDI in textiles and leather, while most of the IPAs in developing Asia and Oceania mentioned (together with tourism) agriculture, forestry and fisheries, which is somewhat surprising, given that sector's relatively low importance in global FDI.[34]

Figure VI.4. Regional distribution of targeted developing and transition economies by host region

(Per cent)



Source: UNCTAD Survey of IPAs, February-March 2006.

In general, IPAs do not discriminate between investments from developed or other countries. However, four IPAs in the UNCTAD survey expressed a preference for FDI from the latter. The IPA from Afghanistan suggested that investment from developing countries might be more relevant to its priority sectors, while the Solomon Islands IPA indicated that it is able to attract only low to medium levels of investment and that FDI from developing countries is geographically more easily accessible. Four IPAs offer preferential measures for FDI from developing countries and transition economies:[35] the Zanzibar Investment Promotion Authority (United Republic of Tanzania) indicated preferential market access and other preferential treatment as specific measures, and the other three IPAs cited regional agreements or economic and trade agreements with developing countries.

3. Reactions to takeovers by TNCs from developing countries

Despite the rising interest among IPAs in attracting capital from the new sources of FDI, not all stakeholders in recipient economies wholeheartedly support such inflows. As part of broad concerns related to the most recent wave of M&As (chapter I), the increased participation of firms from developing and transition economies in this process has triggered reactions in some host countries. Many of the most controversial M&As have involved Chinese companies, but some involved companies from Hong Kong (China), the Russian Federation, Taiwan Province of China and the United Arab Emirates. A few South-South deals have also provoked resistance in host countries.[36]

Two concerns have regularly surfaced. The first is associated with a perceived loss of control over natural or strategic assets, with implications for national security. The second is related to the fear of job cuts, especially when cross-border M&As involve TNCs from developing economies. A brief review of some of these transactions is illustrative.

The most controversial deals have been associated with concerns related to national security. Fears have been especially pronounced when

Table VI.4. IPAs known to have offices in developing or transition economies

IPA	Locations
Developed countries	
ITD Hungary	Bosnia and Herzegovina, Brazil, Bulgaria, China, Croatia, India, Indonesia, Iran, Kazakhstan, Kuwait, Romania, Russian Federation, Serbia and Montenegro, Turkey, Ukraine and Viet Nam
Invest Australia	China and Singapore
Invest in Denmark	China and India
Invest in France Agency[a]	China, Hong Kong (China), India, Republic of Korea, Singapore, Taiwan Province of China
Invest in Sweden Agency	China, India, Republic of Korea and Taiwan Province of China
Japan External Trade Organization	Brazil, China, Hong Kong (China), India, Republic of Korea, Singapore and Thailand
Latvian Investment and Development Agency	China, Kazakhstan and Russian Federation
Malta Enterprise	Libya and United Arab Emirates
UK Trade and Investment	China, Hong Kong (China), Mexico, Republic of Korea, Singapore, South Africa and Taiwan Province of China
Developing countries	
Bancomext (Mexico)	Argentina, Brazil, China, Colombia, Costa Rica, Guatemala, Republic of Korea, Singapore and Venezuela
Botswana Export Development and Investment Authority	South Africa
CORPEI (Ecuador)	Chile
Investment Promotion Agency, Ministry of Commerce (China)	Hungary
Mauritius Board of Investment	India
Namibia Investment Centre	Angola, India, Malaysia and South Africa
Philippines Board of Investment, Department of Trade and Industry	China, Hong Kong (China), Indonesia, Malaysia, Republic of Korea, Singapore, Taiwan Province of China and Thailand
Proexport (Colombia)	Brazil, Chile, China, Costa Rica, Ecuador, Peru and Venezuela
Saudi Arabian General Investment Authority	China and Singapore
South East Europe and CIS	
Armenian Development Agency	Russian Federation

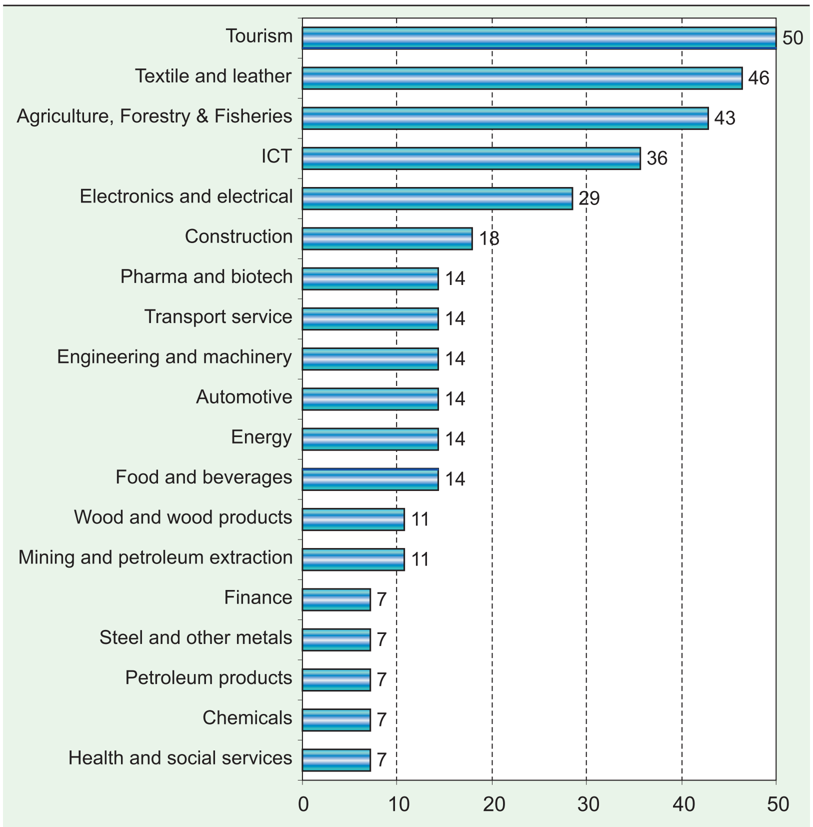
Source: UNCTAD Survey, February-March 2006.
[a] Based on information on the website of the Invest in France Agency.

bidding companies had close ties with their home-country government. Many of the Chinese companies that have made major bids on foreign companies are State-owned, or were founded by branches of the Government.[37] Moreover, national security concerns have primarily involved M&As or other forms of FDI in industries regarded as particularly sensitive, such as:

- *Oil, gas and other mining:* e.g. China National Offshore Oil Corporation (CNOOC) (China) - Unocal (United States), Minmetals (China) - Noranda (Canada), Gazprom (Russian Federation) - Centrica (United Kingdom);
- *ICT:* e.g. Lenovo (China)-IBM (United States),[38] Huawei and ZTE (both Chinese) investments in India;[39]
- *Other infrastructure services*: e.g. Dubai Port World (United Arab Emirates)-Peninsular & Oriental Steam Navigation (P&O) (United Kingdom); Hutchison Whampoa (Hong Kong, China)-container terminal in India.

The cases of CNOOC and Dubai Port World are illustrative. In July 2005, CNOOC announced a $18.5-billion bid for Unocal, the ninth largest oil firm in the United States. The proposed takeover triggered concerns related to national security, unfair competition and the risk of technology leakage (Antkiewicz and Whalley 2006). Due to strong political opposition, the offer was eventually withdrawn and Unocal was taken over instead by Chevron (United States). Some observers cautioned that blocking the Chinese bid might have negative repercussions in terms of the willingness of the Chinese Government to invest in United States bonds or the risk of retaliation against United States companies seeking to invest in China.[40] In the second case, following the acquisition of P&O by Dubai Port World (DPW), strong opposition in the United States was raised against the fact that DPW would take over the management of six port terminals in the United States previously operated by P&O. United States lawmakers and business representatives cited security concerns about an

Figure VI.5. Target industries for IPAs promoting FDI from developing and transition economies
(Per cent)



Source: UNCTAD Survey of IPAs, February-March 2006.

Arab company's taking over the running of the ports.[41] The strong reactions eventually led to DPW's undertaking to sell those terminals to a United States company within six months.

Concerns over foreign takeovers have been voiced in other countries as well. For example, the attempted takeover by the Chinese metal firm, Minmetals, of the Canadian nickel and zinc producer, Noranda, led critics in that host country to cite national security concerns as well as China's human rights record as reasons to stop the transaction.[42] Similarly, security concerns were behind the decision of the Government of India to block a bid in November 2005 by a subsidiary of Hutchison Whampoa (Hong Kong, China), for a container terminal in Mumbai.[43] In the United Kingdom, when it became known that Gazprom (Russian Federation) was considering a bid for Centrica, the largest gas supplier in the United Kingdom, concerns there related to allowing a State-owned company to gain control over gas distribution markets in Europe.[44]

The other main area of concern is employment-related. Trade unions in both North America and Europe have expressed fears that takeovers could result in sharp reductions in the workforce of the target firms. Takeover bids by Haier (China) of Maytag (United States), BenQ (Taiwan Province of China) of Siemens' Handset Division (Germany), and Mittal Steel (Netherlands/ United Kingdom) of Arcelor (Luxembourg) are all examples over which such concerns have been voiced.

In June 2005, the Haier Group, a leading manufacturer of household appliances in China, participated in a bid for Maytag, the third-largest appliance maker in the United States. Haier eventually dropped its bid, and instead Maytag was taken over by Whirlpool (United States), following concerns that Chinese ownership would reduce the number of manufacturing jobs in the United States. The fear of asset-stripping led Maytag employees to favour takeover proposals by a United States firm.[45] When BenQ agreed to take over Siemens' loss-making handset division in June 2005, concerns were expressed by the labour union, IG Metall, that BenQ would cut jobs at its production plant in Kamp-Lintfort. In the end, jobs at this plant were secured until mid-2006.[46]

In 2005, Mittal Steel made a bid for Arcelor. Arguments against the transaction alluded to risks due to the developing-country origins of the bidding company. Technically, Mittal Steel is not a developing-country TNC. It has its headquarters in the Netherlands, and its chairman and CEO, Lakshmi Mittal, resides in the United Kingdom. But of the nine-member Board of Directors, five are Indian citizens. At the same time, the Government of India made statements in favour of Mittal's plans, indicating that it viewed the company as reflecting certain Indian interests.[47] Although no concrete legislative steps were taken to block the transaction, politicians as well as trade union representatives expressed reservations. Trade unions from Belgium, France, Germany, Spain, Luxembourg and Italy unanimously declared that they strongly opposed the hostile takeover bid of Arcelor by Mittal.[48] According to the French Minister of Finance, Mittal was "free to do what it wanted. We could only reiterate the deep concern of the French government".[49] In June 2006, however, the two companies eventually agreed to a merger valued at €26.9 billion.[50]

What are the implications of the recent in political opposition to the M&As involving some TNCs from developing and transition economies?

As far as home countries are concerned, the ownership issue is of particular relevance. First, the level of State ownership in an economy is a political decision at the national level. However, countries in which State-owned, or government-linked companies embark on internationalization through FDI (including via M&As) need to be

Box VI.11. FDI and national security exceptions

In general, most States reserve the right to refuse certain M&As for national security reasons, either under international investment agreements (IIAs) to which they are party or under their national laws.

The majority of IIAs does not contain a national treatment obligation during the admission period. Instead it is left to the host State either to admit FDI outright, admit it conditionally, or reject it. However, IIAs that contain a national treatment obligation extending to the pre-establishment phase, typically apply public policy exceptions to filter out FDI that may pose a risk to their national security. The national security exception in such IIAs is regularly part of broader public policy exceptions that allow countries to block a deal for public policy reasons. The most commonly used are exceptions to safeguard the *national security* of a country, to protect *public order* and *health, life and the environment*.[a] A concern regarding these exceptions is that they could be used to hinder free admission for economic reasons on the pretext of public policy grounds. According to one observer: "difficulties can arise when a host State so interprets its vital national economic and security interests as to create a discriminatory regime for the exclusion of foreign investors from sectors where national firms are under threat from foreign competition" (Muchlinski 1999, p. 175).

Public policy exceptions normally are not well defined. However, differences exist between national security and other exceptions. Most of the latter exceptions, when included in IIAs, are not self-judging, meaning that a country cannot freely interpret the scope and application of the exception. National security exceptions are different. They are usually self-judging and the host State is the final interpreter of the law (i.e. only the host State can judge whether there is a threat to its essential security interests and how it should react to this menace).[b] However, a number of IIAs limit the scope of application of the national security exception by enumerating in an exhaustive list specific categories of cases in which the clause may be invoked (see, for example, Article XIV bis of the GATS). Whereas there exists jurisprudence for some public policy exceptions (such as environmental exceptions), this does not seem to be the case for national security exceptions.

In the context of blocking foreign investments, national security exceptions relate mainly to economic activities in the military sector, such as the trafficking of arms, ammunition

/...

Box VI.11. FDI and national security exceptions (concluded)

and any other transactions of goods, materials, services or technology for the supply of a military establishment which can represent a threat to national security (see, for example, NAFTA Article 2102). Another instance can be investment in infrastructure projects and other sectors that a country considers to be of strategic importance. Even the United States, which generally favours a liberal approach towards FDI, has annexed long lists of sectors to its BITs and free trade agreements (FTAs), making some sectors off-limits to foreign investors. Among the sectors where FDI is often barred are such diverse economic activities as nuclear energy or licences for broadcasting. Their inclusion in such negative lists may also reflect lobbying efforts by domestic interest groups (Pollan 2006, p. 79).

Similarly to IIAs, national laws often exclude or limit foreign ownership in certain sectors to safeguard national security. Bosnia and Herzegovina, for example, limits foreign ownership of enterprises engaged in the production and sale of arms, ammunition, or explosives for military use and military equipment to 49%. The investment code of the Philippines enumerates in its List B a number of activities, which are defense-related such as the manufacture of firearms, ammunition, and lethal weapons. Investing in these areas by foreigners requires special permission.

A prominent developed-country national security exception is the United States' "*Exon-Florio* provision" (Section 721 of the Defense Production Act), which allows the President of the United States to block an acquisition of a United States corporation by a foreigner if found that "(1) there is credible evidence that the foreign entity exercising control might take action that threatens national security and (2) the provisions of law, other than the International Emergency Economic Powers Act do not provide adequate and appropriate authority to protect national security."[c] The provision does not contain a definition of the term "national security", but mentions a number of factors that should be considered. The Committee on Foreign Investments in the United States (CFIUS) supervises its application, and receives notifications by foreign companies (or the company which is to be acquired) prior to, or after, the acquisition.[d]

Section 837(a) of the National Defense Authorization Act for Fiscal Year 1993, called the "Byrd Amendment," amended the "Exon-Florio provision". It *requires* an investigation in cases where the buyer is controlled by or acting on behalf of a foreign government; and the acquisition "could result in control of a person engaged in interstate commerce in the U.S. that could affect the national security of the U.S." This amendment has been of relevance in the context of outward FDI from developing and transition economies, in light of the prominent role that State-owned companies or government-linked companies play in some of these countries (chapter III).[e]

Between 1988 and 2005, a total of 1,593 notifications were made to the CFIUS, 25 investigations were initiated and only one case (China National Aero Tech's bid for MAMCO Manufacturing Inc. in 1990) was actually blocked (Graham and Marchick 2006, p. 57).

Source: UNCTAD.

[a] For exceptions to national security, see, for example, Article 18.2 of the United States model BIT, or Article 2102 of the NAFTA and Article 169 of the Economic Partnership Agreement between Japan and Mexico. For exceptions relating to the protection of human, animal or plant life or health, see, for example, Article 24 of the Energy Charter Treaty, or Article 13 of the Framework Agreement on the ASEAN Investment Area.

[b] The self-judging nature of national security exceptions also becomes evident in the message of the United States President to the Senate regarding the United States–Albania BIT: "Measures permitted by the provision on the protection of a party's essential security interests would include security-related actions taken in time of war or national emergency. Actions not arising from a state of war or national emergency must have a clear and direct relationship to the essential security interest of the party involved. Measures to protect a party's essential security interests are of self judging nature, although each party would expect the provisions to be applied by the other in good faith." See www.wais.access.gpo.gov.

[c] See www.treas.gov/offices/international-affairs/exon-florio/.

[d] CFIUS member agencies are: the Departments of Treasury (Chair), State, Defense, Justice, Commerce and Homeland Security, as well as the National Security Council, National Economic Council, United States Trade Representative, Office of Management and Budget, Council of Economic Advisors and the Office of Science and Technology Policy.

[e] See www.treasury.gov/offices/international-affairs/exon-florio/.

aware of the potential implications and reactions in recipient countries. In some countries (e.g. the United States), the fact that a bidder is State-owned significantly increases the chances that the deal will go through a review process (box VI.11). It is often feared that motives other than purely economic ones drive ownership bids by State-owned companies, particularly if the M&As relate to energy, infrastructure services or other industries with a “security dimension”.

Secondly, whether private or State-owned, outward investors engaging in cross-border M&As may increasingly have to address issues related to corporate governance. This is important, as there are concerns in the North that the acquiring firm may not comply with codes of corporate governance and transparency to which companies in the host economy largely adhere. Thirdly, and more generally, firms need to be aware of the political sensitivities involved in cross-border M&As, and plan their transactions carefully, taking economic as well as non-economic aspects into account.[51]

There may also be a case for ensuring reciprocity with a view to being able to undertake M&As transactions in other countries. For example, in the case of the planned takeover of Unocal by CNOOC, a bill introduced in the United States Senate that specifically aimed “To prohibit the merger, acquisition, or takeover of Unocal Corporation by CNOOC Ltd. of China”, made reference to the fact that the Chinese Government would not allow the United States Government or United States investors to acquire a controlling interest in a Chinese energy company.[52]

From a host-country perspective, recent reactions may partly indicate that many stakeholders are not prepared for the upsurge in M&A activity involving the new sources of FDI. Business leaders, trade unions and policymakers in developed countries may expect to see more of these kinds of transactions in the coming years. Future responses will have to be carefully balanced. What is to be regarded as a threat to the national security of a country is not well defined and therefore largely up to each country to determine (box VI.11). At the same time, countries need to be careful in their decisions, so as not to fuel a trend of increased protectionism that would be in no country’s interest. In some developed host countries, there are fears that an increased politicization of the process through which foreign takeovers are scrutinized may lead to unwanted costs and reduced benefits without actually improving the ability to address national security risks (Graham and Marchick 2006).

There may be important benefits to a host country from having more companies competing to acquire local assets. Indeed, some observers in the relevant host countries have spoken out against stopping some of the deals reviewed above, and warned that opposition to inward FDI may have unwanted consequences. For example, it has been suggested that blocking Huawei’s and ZTE’s investments in India might imply higher costs for the local users of the kind of telecom equipment that the Chinese companies produce.[53] Moreover, the business community in the United States has done little to oppose acquisitions by Asian firms. Local shareholders are likely to benefit from having more potential buyers of their assets. Moreover, many business executives may feel that more is at stake in investments going the other way. A more negative stance towards inward FDI in the form of cross-border M&As might lead other countries to retaliate, which could result in widespread protectionism.[54]

Important parallels can be drawn with the job-related concerns noted above. In some cases, because of their roots in lower-cost locations, developing-country investors have in some cases been seen to present a greater risk of production relocation and job reduction for the host country. Such claims may be hard to substantiate. Companies involved in industries that face tough global competition are likely to be exposed to similar kinds of pressure to restructure and rationalize their operations. Thus it is unlikely that the nationality of the owner will have a major influence on the employment effects of a given company. Rather, the employment impact would primarily be determined by the competitiveness of the business unit concerned. It would be unfortunate if a developing-country origin would be used to hamper the internationalization of developing-country firms.

C. International agreements and FDI from developing and transition economies

The expansion of FDI from developing and transition economies also has implications for the role of international investment agreements (IIAs). The number of bilateral and regional agreements with investment provisions continues to rise, in part driven by increased negotiating activity among developing countries (chapter I). Such South-South agreements may facilitate investment flows among developing countries. At the same time, those economies that are emerging as significant sources of FDI are finding themselves in a new situation in the context of negotiating IIAs. They now have to consider not only the role of such agreements in facilitating inward FDI, but also in creating better opportunities for their own firms to expand abroad. In this section, particular attention is given to selected bilateral and regional agreements, which are of potential relevance to FDI from developing and transition economies.

1. The growing role of IIAs

Many developing and transition economies are actively contributing to the expansion of IIAs at the bilateral and regional level, partly because they view such agreements as helpful not only in attracting inward FDI, but also to facilitate the internationalization of their firms.

The conclusion of bilateral investment treaties (BITs) traditionally involved a developed country on the one hand, and a developing country on the other. In practice, the role of BITs was to protect developed-country firms against political risks, such as discrimination, expropriation and transfer restrictions, while at the same time helping developing countries to attract more FDI. Double taxation treaties (DTTs) were concluded with the objective of ensuring that TNCs (mainly from developed countries) would not be taxed twice for the same business activity.[55] With developing countries emerging as capital exporters, this simplified perspective is becoming increasingly complex. More and more countries find themselves being both recipients and sources of FDI, which means that they have to consider a wider spectrum of priorities when negotiating international agreements. Many developing and transition economies now explicitly mention the promotion of outward FDI as one of the reasons for them entering into BITs and DTTs.[56]

A growing number of bilateral IIAs – BITs, DTTs, free trade agreements (FTAs) or other forms of IIAs – are concluded between developing economies. As of end 2005, more than 1,100 such South-South IIAs had been concluded, of which the number of DTTs had reached 399 – or 14% of the total number of DTTs, up from 10% in 1995. Developing Asia has signed the largest share of DTTs, followed by Latin America and the Caribbean and Africa.[57]

By the end of 2005, the number of “South-South” BITs had grown to 644, representing 26% of the total number of BITs. Countries with large FDI outflows, such as China, Malaysia and the Republic of Korea, are among those with the highest number of BITs. Moreover, China, Egypt and Malaysia have each signed more than 40 such agreements with other developing economies. Asian countries are parties to 68% of all South-South BITs, followed by countries in Latin America and the Caribbean. But far from all outward FDI from the South is covered by BITs. In the case of FDI to other developing economies by nine southern economies that report outward FDI stock by destination, only 20% was covered by a BIT in force as of 2003. These economies represent about 58% of the total outward FDI flows of developing countries.[58]

Developing economies are also concluding FTAs among themselves (as well as with developed countries). Many of these agreements include specific investment provisions (chapter I). The earliest “South-South” FTAs with substantive investment provisions were concluded in Latin America and the Caribbean: between Mexico and Bolivia (1994), Colombia, Mexico and Venezuela (1994), Mexico and El Salvador, and Chile and Mexico (1998), Chile and Central America (1999), Guatemala and Honduras (2000), and Mexico and Uruguay (2003). More recently, other developing countries have followed suit. Singapore has set up a network of FTAs aiming, *inter alia*, at liberalizing the service sectors of its FTA partners and spurring the growth of services and other creative industries.[59] Similarly, the Republic of Korea has concluded a number of FTAs, including with Chile (2004) and Singapore (2005), and is pursuing negotiations with more than 20 economies and regional organizations, including India, Mexico and ASEAN.

South-South bilateral IIAs cover a wide range of cooperation activities and areas, such as trade and labour, aimed at achieving related development goals (UNCTAD 2005m). They differ from other IIAs, not so much in their overall objective, which is to promote and facilitate investment, but in terms of the depth and breadth of their coverage of investment issues (UNCTAD 2005m, p. 31). South-South BITs generally do not grant free access and establishment; they tend to exclude provisions prohibiting performance requirements; and they limit transparency requirements to the stage following the adoption of laws and regulations. Few specific South-South features are discernible in such IIAs, but they tend to address the development concerns of the parties involved more prominently than IIAs in general (UNCTAD 2005m).

It is likely that increased FDI from developing and transition economies will generate a growing demand from the business community in the home countries concerned for greater protection of their overseas investments. In interviews conducted in the context of the preparation of this *WIR*, more BITs and DTTs were mentioned by several TNCs from developing and transition economies when asked how home-country governments could help facilitate their international expansion through FDI. Most respondents also assigned relatively great importance to both BITs and DTTs for their overseas investments.

The focus of developing-country governments in BIT and DTT negotiations may shift from an exclusive emphasis on inward investment promotion to include protection of outward FDI. This has a number of implications. First, developing and transition economies exporting FDI may become more interested in actively demanding higher standards of protection for outward investors. Secondly, the most-favoured-nation (MFN) clause may gain in importance for developing countries, since it may provide their investors with higher standards of protection included in third-country BITs. Thirdly, developed countries may face a higher risk of disputes from investors from developing and transition economies. This might reinforce the already existing trend in some countries (e.g. Canada, United States) to refine the text of individual BIT articles and to review their BIT dispute settlement provisions. The combination of more IIAs with a developing-country party and the internationalization of TNCs from developing and transition economies is already reflected in the rise in the number of investment disputes involving TNCs from these economies (box VI.12).

Box VI.12. Investment disputes involving investors from developing and transition economies

In the wake of rising FDI from developing and transition economies, and the expansion of the IIA universe (chapter I), several investment disputes have emerged with investors from these economies as claimants.

By the end of 2005, 24 of the 226 known treaty-based investor-State disputes (approximately 10%) had been filed by investors from a developing or transition economy. With one known exception[a], all were filed against governments in other developing countries or economies in transition. The most cases have been filed against Chile (5), Argentina (3) and Peru (2). Claimants were predominantly from Chile (5), Argentina and the Russian Federation (3 each), followed by investors from Malaysia, Peru, Singapore and Turkey (2 each). Of the 24 disputes, 22 related to BITs; the remaining 2 concerned the ASEAN Agreement for the Promotion and Protection of Investments.

From the information available, the cases cover claims amounting to at least $1.1 billion. As of 1 May 2006, 18 disputes were still pending, 2 had been won by the foreign investor, and 3 by the host country. The outcome of one dispute is unknown. Sectors involved in these claims include, motorway and road construction, chemical products, electricity distribution and telecommunications. The IIA provisions most frequently invoked include the definition of "investment", the principle of fair and equitable treatment and expropriation.

Given that FDI from developing countries and transition economies is growing rapidly, investor-State disputes involving investors from these economies might increase in the coming years.

Source: UNCTAD.

[a] There is only one known case involving an investor from a developing country and a government of a developed country: the often-cited "Mafezzini vs. Kingdom of Spain" case, which the Argentinean investor eventually won.

2. Regional economic integration agreements and South-South FDI

Policy developments at the regional level are also of potential relevance. This applies in particular if the regional network of BITs is relatively thin. As noted above, there is a strong regional dimension to outward FDI from developing economies in Africa, Asia and Latin America (chapter III). In all these regions, various political initiatives have been taken to create regional trading blocs, often with important implications for investment. More research is needed to assess the impact of regional integration schemes on South-South FDI.

As of December 2005, at least 40 regional South-South trade agreements had been concluded (UNCTAD 2005m), many of them after 1995, thus constituting “a second wave of regionalism” (Cosbey 2004, p. 2).[60] Such integration can influence FDI in different ways. First, by integrating national economies the regional market size increases, making the region more attractive to market-seeking FDI. Secondly, by removing barriers to trade and investment among the members of the integrating area, the scope for production specialization and efficiency-seeking FDI may expand. A larger regional market combined with easier trade across borders within the region can imply greater economies of scale for producers based within the region, and may also attract new actors. Thus, regional integration may in theory facilitate inflows of FDI from outside the region, as well as intraregional flows.

But the extent to which regional integration affects FDI depends on several factors, including the size of the markets of the individual member States and the actual provisions of the agreements, and these can differ from one regional bloc to another. While more and more regional agreements are concluded in developing regions, not all of them deal with investment. In fact many regional South-South agreements have rather modest investment provisions (UNCTAD 2005m, p. 26).

A few salient features of investment-related aspects of South-South regional economic integration are worth noting. First, for some of the regional groupings, the amount of FDI in the South-South context remains small. In these cases, promotion of FDI from non-member States tends to receive the most attention. Second, the rather modest coverage of the investment provisions in many South-South regional economic integration agreements is partly explained by the economic and political diversity of the members. Third, a weak infrastructure connecting the production and trade systems of the different members may limit their ability to develop a larger regional market and hamper any substantial intraregional FDI flows.

Among those regional agreements that do deal with investment, some include provisions that can be seen as particularly relevant from the perspective of South-South FDI. Some agreements seek to boost intraregional FDI by easing the entry of companies from other member States. For example, ASEAN provides national treatment to regional investors both pre- and post-establishment. Others, including the Andean Community, explicitly encourage the establishment of regional TNCs – firms set up by investors from more than one member State and that enjoy the right of admission in all member States. The chosen strategies reflect the political and economic context in which they were developed.

In *ASEAN*, the most important agreements concerning investment are the ASEAN Agreement for the Promotion and Protection of Investments, its 1996 Protocol, and the Framework Agreement on the ASEAN Investment Area (AIA Agreement) (box VI.13). The first two agreements concern investment protection, and the AIA Agreement also focuses on facilitation, promotion and liberalization of FDI. Few studies have assessed empirically the impact of the AIA on intraregional FDI. One analysis concluded that regional integration efforts had generated intra-bloc trade, but that the effect on intraregional investment had been insignificant (Stone and Jeon 2000). Another study found that the AIA has boosted the volume of intra-ASEAN investment flows from Malaysia (Zainal 2005, p. 9). During the period 2001-2003, 17% of FDI inflows into ASEAN came from within the region (ASEAN Secretariat 2005b).

The Andean Group was established in 1988 with Bolivia, Colombia, Ecuador, Peru and Venezuela as founding members. In 1997, it became the *Andean Community*.[61] The main provision of direct relevance to South-South FDI is defined under Decision 292, which allows for the formation of Andean multinational enterprises. These are defined as enterprises in which investors from two or more Andean Community countries own more than 60% of the equity capital. Such enterprises enjoy national treatment in the public procurement of goods and services, the right to remit in freely

Box VI.13. The ASEAN Investment Area and South-South FDI

The original goal of the AIA Agreement was to create a more liberal, attractive and competitive investment area comprising about 530 million people (article 3). Its coverage was later expanded by the Protocol to Amend the Framework Agreement on the ASEAN Investment Area (AIA Protocol 2001), which now covers manufacturing, agriculture, mining, forestry and fishery, and services incidental to these industries. Originally, the first of two goals was to open all industries to ASEAN investors by 2010 and to all investors by 2020 (article 4(b)). The second was to grant national treatment by 2010 to all ASEAN investors and by 2020 to all investors (articles 4(b) and 7(b)). Those deadlines were brought forward. Consequently, reservations for ASEAN investors in the manufacturing sector were eliminated by January 2003.

This broad liberalization is subject to important exceptions. ASEAN member States can specify industries and include them in a "temporary exclusion list" or in a "sensitive list". Industries and investment measures in the sensitive list are not subject to liberalization, while those in the temporary exclusion list are to be phased in at specific agreed dates. In a first review of the temporary exclusion list in 2003 "[M]ember Countries opened up more industries and granted more investment measures to foreign investment by phasing in the list of sectors and investment measures in the Temporary Exclusion List".[a] The Agreement also contains a general exception to the national treatment provision in article 13. A country can impose measures, which do not conform with the national treatment obligation if it needs to protect national security and public morals (article 13(a)); or to protect human, animal or plant life or health (article 13(b)). But measures shall not be discriminatory or constitute a disguised restriction on investment flows. Finally, the Agreement only covers investment other than portfolio investment (article 2(a)).

Source: UNCTAD.

[a] See www.aseansec.org/6460.htm.

convertible currencies all dividends that are distributed, national treatment in tax matters, and the right to establish branches in other member countries.[62] It is not known to what extent the Decision has contributed to the formation of Andean multinational enterprises.

CARICOM was established in 1973, and now includes Antigua and Barbuda, the Bahamas, Barbados, Belize, Dominica, Grenada, Guyana, Haiti, Jamaica, Montserrat, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Suriname and Trinidad and Tobago. CARICOM's Protocol II (article 35b) establishes that members shall not introduce any new restrictions relating to the right of establishment of nationals of other members States except as otherwise provided in the Agreement. It stipulates that regional agreements on foreign investment should accord preferential treatment to investors in the following order (article 35c): nationals of the host CARICOM country, nationals of other CARICOM countries, nationals of the source country, and finally those of other countries.[63] However, some members have yet to enact Protocol II.

MERCOSUR, comprising Argentina, Brazil, Paraguay and Uruguay,[64] regulates intraregional FDI in the Colonia Protocol – a protocol that has not yet been ratified by any of the member States. Its article 2 provides for open admission of investments from member States and contains national treatment and most-favoured-nation (MFN) obligations. The protection of sensitive industries is guaranteed by a negative list approach. The annex to the Protocol contains a list of sectors that are exempted from national and MFN treatment, most of which are key sectors for the member States' economies. Common exemptions include exploration of various minerals, certain public utilities, telecommunications and mass media.[65] There are significant FDI flows among the member countries of MERCOSUR. For example, Argentina and Brazil are among the main sources of FDI into Paraguay.

In Africa, *COMESA* is the largest trading bloc, covering 20 member States with a combined population of over 374 million.[66] It aims, among other things, to establish "a secure investment environment and the adoption of common sets of standards".[67] Member States have agreed to "accord fair and equitable treatment to private investors, to adopt a program for the promotion of cross-border investment, to remove administrative, fiscal and legal restrictions to intra-common market investment and to accelerate the deregulation of the investment process".[68] In principle COMESA's FDI dimension is twofold: it envisages the establishment of COMESA TNCs,[69] and it aims to encourage and facilitate investment flows into the common market.[70] The regional TNCs are intended to be enterprises that are able to compete internationally. However, progress has been hampered by lack of know-how and resources within the region. Member States are currently negotiating an Investment Framework Agreement for the COMESA Common Investment Area, with three negotiation rounds held in 2004 and 2005. The Draft Agreement focuses on liberalization, protection and promotion of investment and builds upon the Framework Agreement of the ASEAN Investment Area.[71] However, it is too early to assess the likely outcome of these negotiations.

The above review suggests that progress has been made in a number of important regional South-South agreements in terms of incorporating provisions that may support intraregional FDI. However, the impact of these provisions on investment patterns remains to be analyzed through empirical studies. Additional research aimed at assessing the investment plans of individual companies may be able to shed light on the interaction between regional integration and South-South FDI.

D. Corporate social responsibility and TNCs from developing and transition economies

Discussions pertaining to corporate social responsibility (CSR) have traditionally revolved around developed-country TNCs and their behaviour in developing countries. However as more and more companies from developing and transition economies expand overseas, their managements too will become increasingly judged on this basis. As noted in earlier chapters, a significant share of the investment from the emerging sources of FDI originates from countries that may be characterized by relatively weak legal and regulatory frameworks. In such situations, CSR issues assume increased importance. A number of developing-country TNCs have already incorporated CSR policies into their business strategies, some of them even becoming leaders in this area (box VI.14). While adherence to various CSR principles may require additional resources, it can also generate important advantages, not only for host countries, but also for investing firms and their home economies.

There is no universally accepted definition of CSR. According to the OECD, it relates to a set of policies often voluntarily adopted by an enterprise in order to reinforce the enterprise's ability "to comply with the law and with other societal expectations that might not be written down in law books" (OECD 2005, p. 3).[72] At the most basic level, socially responsible business behaviour means refraining from doing harm. The main areas considered under the umbrella of CSR include, in particular, environmental protection, human rights and labour practices (see *WIR03*, p. 165).[73] At the UNCTAD XI Conference in 2004, the economic development dimension was introduced in the discussion of corporate responsibility (Sao Paulo Consensus, paragraphs 45 and 58).

The main responsibility for ensuring that companies comply with internationally agreed standards and conventions rests with governments. Most international conventions contain obligations for States, but few legally binding obligations for TNCs (*WIR03*, p.166).[74] Host and home States are therefore obliged to create and implement a legal framework which adheres to standards of international law and gives clear guidelines to TNCs on various social and environmental issues. At a minimum, TNCs should respect in good faith the laws of their host countries without taking advantage of weak legal and administrative systems (*WIR03*, p. 165). In cases where the legal framework is inadequate, falls below internationally agreed minimum standards or is completely absent, TNCs might even be expected to adhere to standards higher than those stipulated by the host country.[75]

According to one study, "there is no vast difference in approaches to corporate responsibility between companies in high-income OECD countries and their emerging market peers", but "[I]n most emerging markets there appears to be a substantial gap between companies that are doing a great deal and those that are doing little or nothing" (OECD 2005, p. 4). Others claim that "generally the more developed the country the higher incidence of policies in the area of CSR" (Welford 2005, p. 52), or they suggest that on the whole TNCs from developing and transition

Box VI.14. Programmes to enhance the social impact of activities: the cases of Cemex and Petrobras

Some developing-country TNCs, such as Cemex (Mexico) and Petrobras (Brazil), are among the leaders in their respective industries in terms of adopting CSR principles.

Cemex, a participant in the United Nations' Global Compact (see box VI.15) since 2004, supports a number of CSR initiatives. Its initiative, Patrimonio Hoy, provides low-income families with access to low-cost materials to build or upgrade their homes. It addresses problems related to the limited financing options available to families that prevent them from residing in or improving their dwellings. The company has established 60 centres throughout Mexico that have so far aided 103,000 families. Between Patrimonio Hoy and Piso Firme (a company programme that has helped 200,000 disadvantaged families replace dirt floors with concrete ones), Cemex is making strides in Mexico to end slum housing and unsanitary conditions, which often have violent outcomes. Both programmes are also being implemented in Colombia.

Cemex is also involved in a wide array of community development projects around the world. It supports or leads educational initiatives in countries such as the Philippines (One Paper, One Pencil programme for children), Costa Rica (scholarships), Egypt (education for girls). For the programme in Egypt – part of the Government's plan to educate 500,000 girls in rural areas – Cemex has provided technical assistance and helped in the construction of schools since 2003. Other programmes include centres for the disabled in Venezuela, mobile health diagnostic teams in Nicaragua, a labour risk education programme in the Dominican Republic, dental care for children in the Philippines and a cultural centre in Colombia.

Another company that has acknowledged the importance of the social dimension in its activities is Petrobras (Brazil). Its operations span 21 countries, many of which have unstable social or political environments. In Brazil, the company has extensive programmes such as those relating to poverty reduction, education, child labour and sexual abuse, and fundamental rights for people with special needs. In a number of host countries, such as Angola, its CSR initiatives include reconstruction projects through humanitarian programmes related to schools, day-care centres, hospitals, rural communities, as well as support socio-cultural organizations. Petrobras also supports management training programmes to develop skills for the oil industry. In Colombia, one of the company's programmes includes the training of community health agents. In Nigeria, it has undertaken an HIV/AIDS prevention campaign in 40 secondary schools in coordination with a local civil society organization.

Source: UN Global Compact.

economies have less experience with CSR than their Northern counterparts (Aykut and Ratha 2004).[76]

Certain characteristics of FDI from developing and transition economies are worth recalling. First, some TNCs are based in home countries that lack a civil society that can freely voice its opinion (Smith 2003, p. 58). The practices of TNCs in such situations are not subjected to the same level of public scrutiny that has raised the level of awareness of CSR issues elsewhere. This makes it important for home-country governments to promote the adoption of universally recognized CSR principles by their TNCs. Secondly, a significant number of large TNCs from developing and transition economies are State-owned and active in extractive industries (chapter III), which raises potential issues related to corporate governance and transparency. Thirdly, a relatively high share of FDI from developing and transition economies flows to other developing countries.

1. Multilaterally agreed CSR principles

International organizations, often in cooperation with States or companies, also have an important role to play in facilitating consensus-building and promoting universally accepted principles that can serve as guidelines for TNCs investing in other developing countries. Prominent initiatives in this regard include the Tripartite Declaration of Principles Concerning Multinational Enterprises and Social Policy (MNE Declaration) of the International Labour Organization (ILO), the OECD Guidelines for Multinational Enterprises, the United Nations' Global Compact, and CSR work conducted by UNCTAD and the International Finance Corporation's Performance Standards on Social and Environmental Sustainability (see also *WIR03*).

The ILO's MNE Declaration is a non-binding universal instrument that articulates a set of principles to guide the global operations of enterprises and their social policies.[77] It aims to encourage TNCs to reinforce their positive contributions to economic and social development, and to minimize and resolve any difficulties that might result from their operations. Its principles provide guidelines for general economic and social policy, employment, working conditions, training and industrial relations.[78] The principles are intended to inspire good CSR practices on the part of enterprises from both developing and developed countries.

The OECD Guidelines for Multinational Enterprises, originally adopted in 1976 and revised in 2000, are a comprehensive and detailed CSR instrument of interest to developed and developing countries alike. The Guidelines provide government-backed recommendations covering such broad areas as human rights, supply chain management, labour relations, the environment, combating bribery, technology transfer, consumer welfare and taxation. The 39 adhering Governments (the 30 OECD member States and Argentina, Brazil, Chile, Estonia, Israel, Latvia, Lithuania, Romania and Slovenia) have signed a formal commitment to promote observance of these recommendations by companies operating in or from their territories. The Guidelines are part of a package of instruments that help to define both corporate and government responsibilities in relation to international investment. The OECD is actively seeking to expand the list of non-member adherents.

The Global Compact was launched by the United Nations Secretary-General in 2000. It is the world's largest voluntary corporate citizenship initiative, with more than 3,200 business participants and other stakeholders from 94 countries. More than half of the Global Compact's participating companies are based in developing countries. Derived from universally agreed international declarations and conventions, its 10 principles – in the areas of human rights, labour standards, the environment and anti-corruption – enjoy political and social legitimacy virtually everywhere in the world (box VI.15). Participants are expected to both internalize the principles within the company's strategies, policies and operations and undertake projects to advance the broader development goals of the United Nations. The Global Compact works closely with business, governments, labour, specialized United Nations agencies, and civil society organizations, such as Transparency International in the field of anti-corruption and Amnesty International in the area of human rights. Local networks, which carry the message to the grassroots, have emerged in 53 countries. The initiative has experienced strong and growing engagement by companies from economies such as Brazil, China, Egypt, India, Indonesia, Mexico, Pakistan, South Africa and Turkey.

In April 2006, the United Nations Secretary-General launched another initiative: the Principles for Responsible Investment (PRI). These Principles provide a framework for institutional investors – including asset owners and investment managers – to integrate consideration of environmental, social and governance issues into investment decision-making and ownership practices, a process which has been linked to better long-term financial returns as well as a closer alignment between the objectives of institutional investors and those of society at large.[79] Already in May 2006, investment funds representing more than $5 trillion in assets had declared their support for these principles.

The International Finance Corporation (IFC) has developed environmental and social standards that are applied when the IFC makes an investment. In 2004-2005, the IFC conducted an extensive consultation process during the review of its 1998 Safeguard Policies. Its standards were revised[80] and served as the model for the Equator Principles – a voluntary set of guidelines for managing environmental and social issues in project financing. The Principles were developed and adapted by leading financial institutions in 2003 (box VI.16). Forty-one of the most important institutions that finance projects in developing countries have signed up to the Principles. Consequently, enterprises involved in such projects, as well as the projects themselves, are increasingly being measured against CSR principles and performance.

UNCTAD's work relating to corporate responsibility has contributed to guidance on corporate transparency in the areas of environmental efficiency, corporate governance, and the social and economic impact of corporations

Box VI.15. The 10 principles of the United Nation's Global Compact

The Global Compact's 10 principles in the areas of human rights, labour, the environment and anti-corruption are based on universal consensus and are derived from the Universal Declaration of Human Rights, the ILO's Declaration on Fundamental Principles and Rights at Work, the Rio Declaration on Environment and Development, and the United Nations Convention Against Corruption. The Global Compact asks companies to embrace, support and enact, within their sphere of influence, a set of core values in the areas covered by the Compact:

Human Rights

- Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
- Principle 2: make sure that they are not complicit in human rights abuses.

Labour Standards

- Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- Principle 4: the elimination of all forms of forced and compulsory labour;
- Principle 5: the effective abolition of child labour; and
- Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

- Principle 7: Businesses should support a precautionary approach to environmental challenges;
- Principle 8: undertake initiatives to promote greater environmental responsibility; and
- Principle 9: encourage the development and diffusion of environmentally friendly technologies

Anti-Corruption

- Principle 10: Businesses should work against all forms of corruption, including extortion and bribery.

Source: UN Global Compact.

on host countries. This work has been part of the intergovernmental consensus-building process of the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR).[81]

2. Benefits for TNCs from the South from addressing CSR issues

There are more than ethical reasons for TNCs from developing and transition economies to pay attention to CSR issues. Whereas it may in many instances incur costs for the company, it may still be money well spent, especially for those competing head-on with developed-country firms. Moreover, for TNCs that invest in "high-risk zones", where the regulatory framework is weak or absent, CSR behaviour becomes essential. Failure to adopt such behaviour may result in the TNC becoming embroiled in major governance failures that lead to adverse, possibly catastrophic, social consequences for the host community, for which the firm in question may be held to blame. In this regard companies may need to ensure that their risk assessment procedures allow for the effects of weak governance, by adhering to CSR approaches to corporate policy-making and decision-taking. This may include, for example, conforming with international CSR instruments and obeying national laws, ensuring that their management pays closer attention to auditing and other regulatory requirements, refraining from improper involvement in local politics, avoiding corruption and speaking out about any wrongdoing (see also OECD 2006e).

In recent years, CSR issues have received greater attention by corporate boards, with many companies deciding to pursue CSR policies. Adherence to accepted CSR principles has become so common among global firms that, in order to compete successfully, TNCs from developing and transition economies may also need to adopt similar practices. Companies have done so not merely for public relations purposes; increasingly they also recognize that good practices might influence corporate performance. In fact, some recent research suggests a positive link between CSR awareness and business performance. The so-called business case for CSR has been validated by a number of studies (e.g. IFC et al. 2002).[82] Some of them, such as the *Responsible Competitiveness Index*, indicate that increased competitiveness is positively related to an improvement in corporate

Box VI.16. The Equator Principles

The Equator Principles are a voluntary set of guidelines for managing environmental and social issues in project financing, developed by leading financial institutions with the IFC's advice and guidance. They apply to development projects in all sectors.

As of April 2006, 41 financial institutions had adopted the Principles, representing 80% of global project financing.[a] The list includes five Brazilian financial institutions. While the commitment given by these institutions is to apply the Equator Principles to projects with a total capital cost of $50 million or more, they are often applied also to smaller projects, and sometimes also in the context of advisory services.

In February 2006, the IFC's Board approved a new set of environmental and social policies for the institution, which incorporated a set of eight Performance Standards on Social and Environmental Sustainability, to be applied to all IFC investments. The financial institutions adhering to the Equator Principles had constituted an active stakeholder group during the consultation process for the new policies, and indicated the intention to update the Equator Principles once the new IFC policies were finalized. This commitment led to the revised Equator Principles, which became effective on 1 July 2006.

Source: IFC.

[a] Total loans for project finance in 2005 amounted to $120.7 billion, of which $97.5 billion or 80% were provided by banks participating in Equator. Current participants are: ABN Amro, Banco Bradesco, Banco do Brasil, Banco Espírito Santo Group, Banco Itaú, Banco Itaú BBA, Bank of America, Bank of Tokyo Mitsubishi, Barclays, BBVA, BMO Financial Group, Caja Navarra, Calyon, CIBC, Citigroup, Credit Suisse Grp, Dexia, Dresdner Bank, Eksport Kredit Fonden, FMO, HSBC, HVB Group, ING, JPMorgan Chase, KBC, Manulife Financial Corporation, Mediocredito Centrale, Millennium bcp, Mizuho Corporate Bank, Nedbank, Rabobank, Royal Bank of Canada, Royal Bank of Scotland, Scotiabank, Standard Chartered, Sumitomo Mitsui, Unibanco, Wells Fargo & Company, WestLB and Westpac.

responsibility practices (AccountAbility 2005). Increased awareness of CSR may enhance an enterprise's long-term competitive position through improvements in access to finance, partners and markets, and a reduction of legal and operational risk.

Enhancing access to funding. Corporations that go public face increased pressure to adhere to responsible business practices in order not to undermine the performance of their initial public offerings (IPOs). For example, the IPO of China National Petroleum Company (CNPC) on the New York Stock Exchange in 2000 was in part affected by the company's engagement in Sudan, which had been criticized by human rights groups. Despite an effort to restructure the IPO, a smaller sum was raised than originally expected. Moreover, CNPC has in the past been the subject of divestment campaigns.[83] The tendency for investors to make CSR considerations part of their investment decisions has gained importance in recent years. According to the 2005 United Nations Global Compact Shanghai Declaration, "the financial community is increasingly connecting environmental, social and governance performance to a company's overall valuation, thereby placing a premium on businesses that responsibly manage such risks and opportunities." As noted above, the CSR dimension is also assessed in the context of project financing by the IFC as well as various development banks.

Cooperation with partners from developed countries. During the past decade, developed-country firms have increasingly been pressured to improve their performance on CSR issues. In diverse industries they are increasingly held responsible for the behaviour of their business partners and for the entire value chain of which they are a part. Developing-country TNCs that aim to become members of these value chains, or otherwise partner with developed-country TNCs, need to be aware of the CSR dimension when they are evaluated as potential business partners.

Market access. TNCs from developing and transition economies that are entering developed-country markets, can expect to encounter the same set of pressures from these markets that have encouraged greater CSR practices among developed-country TNCs. The same degree of responsibility for supply chains that has been applied to developed-country enterprises can be expected to be applied to TNCs from developing countries.

Reduction of legal risk. Investments in host countries with a weak legal infrastructure can expose a TNC to novel forms of legal risk. One significant development is the emerging practice of foreign direct liability litigation, which can allow a TNC to be held liable in one country for its actions in another. At present, the main example of foreign direct liability is the use of the Alien Tort Claims Act (ATCA) in the United States.[84] The United Nations Special Representative on Human Rights and TNCs has noted that, even though ATCA currently remains a limited tool, there are reasons to believe that corporate liability may become an issue under domestic criminal law in a number of jurisdictions (United Nations 2006, para 63). The situation is still fluid "with some indication of a possible future expansion in the extraterritorial application of home country jurisdiction over transnational corporations" (Ibid, para 64). These observations are of relevance also to TNCs from developing and transition economies.

Reduction of operational risk. Developing-country TNCs in the extractive sector are the most likely to invest in high-risk regions, which may entail exposure to weak governance or even conflict. On the one hand, TNCs that invest in such places can provide new jobs and livelihoods for the local population, thereby contributing to peace-building (Gerson 2000). On the other hand, such FDI has sometimes aggravated or reignited conflict, directly or indirectly contributed to the violation of human rights, or prolonged autocratic governance (Collier and Hoeffler 2000, Campbell 2002, United Nations Commission on Human Rights 2006). Enterprises investing in these areas should be aware of the potential risks and benefits, and may find the adoption of CSR policies, in particular in the field of human rights and anti-corruption, useful for enhancing the results of the overall investment.

Thus there are several reasons for developing-country companies as well as governments to consider ways of addressing the CSR dimension of international business. Of course, the content of CSR and the emphasis placed on different issues may vary by country, industry and firm. Nevertheless, the promotion of universally agreed principles could serve as a useful basis for further work in this field.

3. Encouraging good practices

Besides widely accepted CSR principles, such as those included in the Global Compact, an assessment of what is considered responsible behaviour needs to be analysed on a case-by-case basis. Given that many issues related to CSR are contextual, careful analysis is needed to define what standards and practices are the most appropriate in each country. Host countries may have to examine their own governance structures and systems, since the need for CSR often arises when a State's governance is weak or breaks down.

Home countries may seek to create a legal and institutional framework that promotes adherence by firms to widely recognized principles of CSR. CSR awareness can also be enhanced by active consumer organizations, trade unions, environmental groups and the media. Civil society actions can induce companies to become sensitive to stakeholder interests and to adjust internal procedures accordingly. Governments can also stimulate and facilitate dialogue between companies and their external stakeholders (see also Hamann and Acutt 2003). Both home and host country governments may also actively participate in the ongoing formulation of new guidelines and voluntary principles to ensure that standards being formed adequately reflect their particular interests.

Some developing-country governments are acknowledging the link between CSR and competitiveness. According to the Deputy Prime Minister of Malaysia (OECD 2005, p. 12):

> "CSR helps improve financial performance, enhance brand image and increases the ability to attract and retain the best work force contributing to the market value of the company by up to 30 per cent. All of these translate into better client and customer satisfaction, improved customer loyalty and ultimately into lower cost of capital as a result of better Risk Management. Finally from a national standpoint, a good reputation for CSR will help Malaysian companies compete in world markets by resolving the potential concerns end users may have in developed markets."

A number of developing economies are establishing a regulatory and cultural environment that supports CSR standards. Such initiatives are sometimes driven by governments and at other times by business associations, non-governmental organizations or international organizations.

South African firms stand out in that they are embedded in an environment that gives prominence to CSR issues. In South Africa, the State has played a crucial role in defining CSR and in motivating companies to adopt such practices (Hamann and Kapelus 2004, p. 89). In 1994, the first King Report on Corporate Governance was published, and was followed by public discussion which resulted in the report's wide-ranging recommendations being implemented in laws (Institute of Directors in Southern Africa 2002). In addition, in July 2004 the Johannesburg Stock Exchange (JSE) was the first on the continent to launch a socially responsible investment index. Companies applying to be listed on the index have to meet 94 criteria related to environmental, economic and social sustainability (JSE 2005, Finlay 2004). They are regularly reviewed to assess their commitment to these criteria. The review also extends to the outward investment activities of companies listed on the JSE, even though some small adjustments in the criteria are made for such activities. Nevertheless, a company should show for all operations "that it applies a core set of principles, which at least meet globally accepted principles in relation to the relevant issues" (JSE 2005, p.6).

Actors other than the State can also play an important role in providing a conducive framework for CSR. In South Africa, the African Institute of Corporate Citizenship (AICC) is an NGO committed to promoting responsible business behaviour throughout Africa. Among its activities are the African Corporate Sustainability Forum (a multi-stakeholder platform), the Centre for Sustainability Investing (aimed at the financial sector), and a competitiveness and innovation programme. In Latin America, the Ethos Institute in Brazil is a leader in this area, representing some 900 companies that account for 30% of Brazil's GDP and about 1.2 million employees. The Institute is committed to helping companies become more socially responsible. It focuses on activities such as expanding the CSR movement in Brazil, deepening CSR practices and developing CSR criteria. Even though it currently works mainly in Brazil, it explicitly refers to CSR also as an international issue. In Asia, the Asia Pacific CSR Group was launched in July 2004, bringing together nine country-level CSR organizations in the region.[85] Members of the Group engage in active learning exchanges and practices, networking and sharing of information. Its goals include the recognition of standards and benchmarks for corporate governance and good business practices in the fields of environmental protection and equitable human resource management.

In the case of FDI in extractive industries, there are various resources that can help both companies and countries to address certain CSR-related issues, including ensuring the transparency of revenue flows originating from extractive industries[86] or dealing with human rights issues when confronted with weak governance.[87]

The participation of the TNCs themselves is an essential ingredient for the success of CSR initiatives. CSR issues pose new challenges to some enterprises from developing countries, whereas others have already incorporated them into their strategy.[88] For future planning it is not enough to evaluate only the risk in a company's undertakings, but also the risk a company's actions can pose for other stakeholders. The emergence of new developing-country TNCs and their participation in the global market will draw increasing attention to this issue. Moreover, as highlighted in chapter V, developing-country TNCs can be an important channel to transmit CSR-related values and standards to their home economies. Increased awareness of CSR can be expected to benefit the TNCs, as well as their home and host countries. It is therefore important that CSR-related issues be seen as part of a broader set of policies that support entrepreneurship, corporate governance and competitiveness.

E. Concluding remarks

In the context of FDI and development, there are important interactions between corporate strategies and public policies at the national and international levels. The rise of FDI from developing and transition economies is no exception. Proactive government policies can help countries – be they sources or recipients of such investment – to benefit from such investment activity. By providing the appropriate legal and institutional environment, home-country governments can create conditions that could induce their firms to invest overseas in ways that could benefit the home economy. Host-country policies can similarly affect the volume and net impact of inward FDI from developing and transition economies. Indeed, the emergence of

TNCs from these economies as key regional or global players in their industries is paralleled by important changes in policies governing FDI and related matters. Based on this chapter's review of these changes, some general observations can be made.

From a home-country perspective, more and more developing and transition economies are dismantling barriers to outward FDI. While many of them still have some forms of capital control to mitigate the risk of capital flight or financial instability, such a restriction is mostly aimed at limiting international capital flows other than FDI. Only a handful of developing countries today have outright bans on outward FDI, as they are increasingly recognizing its potential benefits. A number of governments, especially in developing Asia, are even using a variety of supportive measures to encourage their firms to invest abroad. Such measures include provision of information, match-making services, financial or fiscal incentives, as well as insurance coverage for overseas investment. Given the relatively short period of time that such measures have been in place, little is known about their effectiveness in facilitating outward FDI and its associated potential benefits.

There is no one-size-fits-all policy that can be recommended to deal with outward FDI. Every home country needs to adopt and implement policies that are appropriate to its specific situation. Whether a country will benefit by moving from "passive liberalization" to "active promotion" of outward FDI depends on many factors, including the capabilities of its enterprises and the links of the investing companies with the rest of the economy. Certain local capabilities are needed to be able to successfully exploit the improved access to foreign markets, resources and strategic assets gained from outward FDI. Moreover, domestic enterprises will need a certain level of absorptive capacity to benefit from outward FDI. In many low-income countries, it may therefore be more cost-effective to focus on creating a competitive business environment at home than to promote outward FDI.

Nevertheless, for those countries that decide to encourage their firms to invest abroad, it is advisable to incorporate policies dealing specifically with outward FDI within a broader policy framework aimed at promoting competitiveness. For example, given the importance of generating domestic capabilities to benefit from outward investment, it is appropriate to link policies on such investment with those relating to SME development, trade and innovation. Moreover, outward FDI is only one of several ways in which a country and its firms can connect with the global production system. Therefore, close coordination with policies aimed at attracting inward FDI, promoting imports or exports, migration and technology flows would also be advisable.

Among developing and transition economies, those in South, East and South-East Asia are the largest users of measures to promote outward FDI. Several of these countries do this through trade promotion organizations, IPAs, export credit agencies and/or EXIM banks. A variety of policy instruments are applied in innovative ways, often targeting specific types of outward FDI. Some governments in Africa and Latin America have also publicly stressed the importance of outward FDI, but have rarely followed up with concrete promotional measures. Indeed, in many developing countries, the promotion of investment overseas remains a sensitive matter.

Particular attention should be paid to the role of outward FDI in the context of South-South cooperation. Governments in Asia (e.g. Malaysia, India, Singapore) and Africa (e.g. South Africa) have outlined specific programmes to facilitate South-South investment. Some programmes are aimed at strengthening intraregional development (as in the case of infrastructure-related FDI by South African State-owned enterprises), and others are interregional in scope. This is an area that could be further explored and supported through closer collaboration among developing-country institutions. An interesting recent UNCTAD initiative in this area is the establishment of the G-NEXID network, aimed at promoting the sharing of experiences among EXIM banks from developing countries.

There are also implications for policy-making in host countries. For example, the scope for South-South FDI has led many developing host countries to adopt specific strategies to attract such investment. In a 2006 UNCTAD survey of IPAs, more than 90% of all African respondents stated that they currently target FDI from other developing countries, notably from within their own region. Indeed, for African IPAs, South Africa tops the list of developing home countries targeted, while in Latin America and the Caribbean, Brazil is the most targeted country. Meanwhile, developed-country IPAs also court investors from the new home economies. A significant number of such agencies have already set up local offices for that purpose in countries such as Brazil, China, India, the Republic of Korea, Singapore and South Africa. This growing diversity of potential sources of FDI may give recipient countries greater bargaining power to the extent that they are able to attract a larger number of investors to compete for existing investment opportunities.

Notwithstanding the interest in FDI from developing and transition economies, some observers are less enthusiastic about the new investors. Some cross-border M&As by developing-country TNCs that have close links with their respective governments have generated national security concerns, and other deals have prompted fears of job cuts. Countries in which State-owned enterprises embark on internationalization through FDI need to be aware of the potential sensitivities involved. In some countries, State ownership is seen as presenting an increased risk of a transaction being undertaken for other than purely economic motives. This applies in particular to energy, infrastructure services or other industries with a “security dimension”. Whether private or State-owned, outward investors from developing and transition economies that are anxious to tap the markets and resources of developed countries may also have to address more fully issues related to corporate governance and transparency.

As far as recipient countries are concerned, business leaders, trade unions as well as policymakers should expect to see a continued rise in transactions involving companies from developing and transition economies as buyers. There may be important benefits to a host country from having more acquiring companies competing for local assets. A negative stance vis-à-vis inward FDI might result in higher prices for consumers, lower returns for shareholders and may generate a wider protectionist sentiment. Countries therefore need to be prudent in their use of legislation aimed at protecting national security interests so as not to fuel a spate of protectionism that would be in no country’s best interests.

Beyond the level of national policy-making, this chapter has noted that the interest of developing and transition economies in international investment agreements may also shift. Increased FDI from these economies is likely to generate growing demand from the business community in the home countries concerned for greater protection of their overseas investments. As a consequence, in addition to using international agreements as a means to promote inward FDI, developing-country governments will increasingly consider using them to protect outward investments. This may result in an additional challenge for developing country governments to balance their need for regulatory flexibility with the interest of their own TNCs investing abroad.

Finally, CSR issues are likely to become more important as companies in developing and transition economies expand abroad. Discussions related to CSR have traditionally revolved around developed-country TNCs and their behaviour in developing countries. The managements of latecomer TNCs from developing and transition economies will be exposed to similar issues. While adherence to various internationally adopted CSR standards may entail costs for the companies concerned, it can also generate important advantages, not only for the host country but also for the investing firms and their home economies.

In conclusion, policymakers in countries at all levels of development need to give greater attention to the emergence of new sources of FDI. There is scope for further sharing of experiences among policymakers from developing and transition economies with a view to maximizing the developmental impact of this recent phenomenon. For example, South-South cooperation may enhance the possibilities of cross-border investments contributing to development for both host and home countries. From the perspective of FDI between developing and transition economies on the one hand and developed countries on the other, there is also a need for dialogue, increased awareness and understanding of the factors driving this FDI and their potential impacts. UNCTAD and other international organizations have an important role to play in this context by providing analysis, technical assistance and, not least important, forums for exchanging of views and experiences to foster consensus-building and help developing and transition economies realize the full benefits from the rise of these newly emerging sources of FDI.

Notes

1 It seems that the more competitive and outward-oriented the regime, the more dynamic is the technology upgrading process (Lall 2000).

2 Another reason may have been the publication of the early research results discussed in Section 3, which suggested

that outward investment did not seem to pose any threat to home-country exports (Blomström and Kokko 1997).

3 In the case of Germany, the controls on outward FDI are imposed for security reasons on investments in certain public enterprises in Myanmar, in accordance with United Nations Security Council resolutions.

4 Outward direct investments in a limited number of industries, such as the manufacture of arms, require prior notice.

5 The United States imposes controls on certain investments such as transactions with or involving Cuba and Cuban nationals, the Islamic Republic of Iran, Iraq, the Libyan Arab Jamahiriya, Myanmar and Sudan, and with persons who commit, threaten to commit or support terrorism. Its rules on export controls may also limit outward FDI. Although the purpose of these rules is to keep military technologies outside the reach of potential enemies, they also limit certain kinds of civilian foreign investment. Recently, for example, this may have limited Boeing's ability to invest in production facilities in China.

6 Neither Taiwan Province of China nor the Republic of Korea began liberalization in earnest until they had accumulated a sizeable current-account surplus. Moreover, during the Asian financial crises, a number of countries restricted outward FDI and postponed the lifting of these restrictions until their balance-of-payments situation had improved.

7 For example, in Uzbekistan, the Agency for Foreign Economic Relations must be notified of the registration of an enterprise abroad (IMF 2005).

8 It began in 1962, when FDI was allowed, but still significantly restricted. In 1979, restrictions were relaxed further and in 1987, foreign exchange controls were eased, when a large reserve of foreign exchange had been accumulated. By 1995, approval was subject to a broad list of national interest criteria, including those related to the acquisition of needed natural resources, parts and components for domestic industries, for the improvement of regional trade imbalances, the encouragement of technical know-how through imports, and for assistance in domestic industrial restructuring (*WIR95*).

9 In the Bahamas, South Africa and the Solomon Islands approval for FDI projects takes into account the potential impact on the home economy, for example, as regards exports of goods and services and the balance of payments (IMF 2005).

10 This applies, *inter alia*, to the Bahamas, Brazil, Cameroon, India, Lesotho, Malaysia, Namibia, the Philippines, Swaziland and Turkey. For example, India offered an automatic clearance route for investments not exceeding $100 million in 1999, and any amount up to 200% of their net worth in 2005 (UNCTAD 2005e, p. 11).

11 It should be noted that controls on foreign investments of domestic financial institutions can be either prudential rules or capital controls, depending on whether there is a differentiation between domestic and foreign activities of the regulated entities. Limits on investments by banks in non-financial enterprises are an internationally accepted prudential rule. However, if only investments in non-financial enterprises abroad are limited or prohibited, it is considered a capital control.

12 UNCTAD Survey of Governments in developing countries and in South-East Europe and the CIS, January-March 2006.

13 Eritrea, for example, declared in its Macro-Policy of 1994 (item 15.2.d.) that it it will "encourage Eritrean investment abroad". This may have been part of the country's regional strategy to encourage its State-owned enterprises and private investors to invest in neighbouring countries such as Ethiopia and the Sudan. To that end, it opened an account with the Bank of Ethiopia so that Eritrean investors in these countries could use it for letter of credit transactions.

14 Speech given by Prime Minister Manmohan Singh at "The Indian CEO: Competencies for Success Summit", 22 January 2005 (www.ficci.com/media-room/speeches-presentations/2005/jan/jan22-ceo-pm.htm).

15 Budget Speech, Trevor A. Manuel, Minister of Finance, South Africa, 21 February 2001.

16 President Lula's address at the Portuguese Industrial Association, Lisbon, 11 July 2003.

17 Lecture given by the Minister for Development, Industry and Foreign Trade, Luiz Fernando Furlan, at Fundacao Dom Cabral, 22 March 2003.

18 In the Republic of Korea, the Bank of Korea, the EXIM Bank, the Center for Overseas Investment Services (COIS) in the Korean Trade-Investment Promotion Agency (KOTRA) all act as resource centres for the provision of information. In addition, the COIS assists companies in identifying potential business opportunities and joint venture partners abroad.

19 The Singapore-led investors in the Singapore-Suzhou Industrial Park, such as Temasek, downgraded their involvement from 65% to 35% in 2001, in favour of a local Chinese consortium, and they allowed commercial Singaporean consortia, including the real estate development consortium Ascendas, to take the lead. Ascendas is the lead partner not just in the International Tech Park in Bangalore, but also in more recent developments such as Cyber Pearl and The V in Hyderabad, and the International Tech Park in Chennai.

20 One of the programmes offered is called shared services, which is intended for all growth stages of IT SMEs. Various marketing and investor-relations programmes have been widely used by companies trying to establish a presence in markets abroad (Ministry of Information and Communication, Republic of Korea).

21 All resident companies at iParks are required to cover their own expenses.

22 Among developed countries, there were similar responses in Slovenia. In a survey, 70% of Slovenian firms covered under a special promotional programme during 2002-2004 (which offered financial grants to firms investing abroad) mentioned that they would have invested abroad even without the public support (Svetlicic, 2005, p. 4). As a result, the Government decided to abolish the programme.

23 In Latin America and the Caribbean, the Dominican Republic offers some loans, and Suriname offers equity finance for outward FDI.

24 Such risk can take the form of outright or "creeping" expropriation, breach of contract, currency inconvertibility and transfer restrictions, and war and civil disturbance, including terrorism.

25 The Berne Union (officially the International Union of Credit and Investment Insurers), is the leading organization for export credit and investment insurance

agencies aimed at facilitating cross-border trade and FDI. Its membership comprises private and public companies as well as multilateral organizations. In 1993, the Berne Union and the European Bank for Reconstruction and Development began the Prague Club, a network for exchanging information for new ECAs in Central and Eastern Europe that did not then meet the entrance requirements for the Berne Union. The Prague Club's membership later expanded to include agencies in Asia and Africa, reaching a total of 30 members in 2006.

26 The EXIM Bank of Thailand encourages FDI that augments foreign exchange income or savings by supplementing commercial banks' services that are lacking or not efficiently available; see: www.exim.go.th/eng/about_exim/vision_mission.asp.

27 For example, the State-owned company, Eskom, has established a dedicated NEPAD team to facilitate the mobilization of Eskom's resources to promote, develop and implement NEPAD's related projects in the energy and, in particular, the power sector.

28 MASSCORP has links with markets in Africa and Asia and organizes business forums/dialogue sessions between its members and visiting South-South Heads of State and their business delegations, undertakes trade and investment missions and exhibitions in other developing countries, and maintains a library of information on South-South investment opportunities.

29 In March 2005 a Memorandum of Understanding was signed by the Export-Import Bank of India, African Export-Import Bank, Andean Development Corporation, Export-Import Bank of Malaysia, and Eximbanka SR (Slovakia). And in March 2006, these institutions were joined by eight more agencies.

30 See UNCTAD/PRESS/IN/2006/005, 14 March 2006.

31 The aim is to commercialize more than 200 of the world's leading technologies or products in the global market by 2012 through the development of 80 core technologies in growth industries (Republic of Korea 2004).

32 The promotion of inward FDI into natural resources may call for a somewhat different approach.

33 Other target economies cited by at least 10% of IPAs that indicated specific targets include Brazil, Hong Kong (China), Pakistan, the Russian Federation, Singapore, Taiwan Province of China, Thailand and the United Arab Emirates.

34 Very few IPAs in Latin America and the Caribbean indicated that they target particular industries.

35 These IPAs are located in the United Republic of Tanzania, Venezuela, Serbia and Montenegro and the Solomon Islands.

36 Opposition in developed countries against takeover bids has not been confined only to transactions involving TNCs from the South; several deals among European companies, for example, have triggered similar reactions, in some cases leading the European Commission to stress that individual member countries should not favour national takeover bids. The Commission's President made the point that "defending national champions in the short-term usually ends up relegating them to the second division in the long-term" (See "EU commission warns against protectionism in Europe", *EU Business*, 15 March 2006 and "EU to sue Spain over 'illegal' energy-merger blocking law", *EUBusiness*, 24 February 2006).

37 Even Lenovo — a public company listed in Hong Kong (China) — has close ties to the Government. Its parent company and largest shareholder, Legend Holdings, is controlled by the Chinese Academy of Sciences, a Government institution that manages national scientific research efforts in China.

38 In May 2005, the Beijing-based Lenovo Group acquired IBM's personal computer business, thus becoming the world's third largest PC producer. The purchase met initial opposition in the United States. The Committee on Foreign Investment in the United States (CFIUS) had considered blocking the deal over national security concerns but eventually consented to the transaction. The transaction was also scrutinized by the Departments of Justice and Homeland Security. See "Security objections to IBM-Lenovo deal?", *eSecurity,* 24 January 2005.

39 Huawei's plans to set up a telecom equipment manufacturing affiliate in India were blocked for national security reasons by the Government as the Foreign Investment Promotion Board and the Department of Telecom. Investment plans of ZTE, another Chinese telecom equipment company, have been delayed for two years pending a decision by Indian security agencies to allow the start of manufacturing in India. See e.g. "Raising the red scare in India's telecom sector", *Asia Times,* 16 November 2005.

40 See e.g. "The Big Tug of War over Unocal", *New York Times*, 6 July 2005.

41 Ibid.

42 The Government of Canada also introduced Bill C-59 to amend the Investment Canada Act (ICA) in order to allow the Government to conduct an investment review on national security grounds, regardless of the size of the transaction. While some observers saw the Bill as a mechanism to stop investments that could be politically unpalatable, such as the takeover of Noranda by the Chinese State-owned Minmetals, the then Minister of Industry stated that the Bill was not aimed specifically at the oil or resource sectors. The Bill did not go beyond a first reading in the House of Commons so has not been passed into law. See, for example, "Bill C-59: Foreign investment will become unpredictable and politicized if Ottawa caves in to vague national interest concerns," *National Post* [Toronto], 19 July 2005, p. FP 19; and "National security bill not aimed at energy takeovers: Emerson," *The Globe & Mail* [Toronto], 15 July 2005, p. B1.

43 The company failed to pass the security investigation because of its "Chinese background". It was the second time that a planned investment by this company was blocked due to "security concerns". See "Li Ka-shing was disqualified for bidding for an Indian part", *International Finance News,* 8 November 2005.

44 Centrica is the largest utilities company in the United Kingdom, accounting for 58% of the country's residential gas market and 23% of the power market. In April 2006, the United Kingdom's Trade and Industry Secretary made it clear that the Government would not intervene if a takeover bid was announced: "Whatever the difficulties and challenges of globalization, the answers will not be found in the stagnant waters of protectionism," he said. See e.g. "UK will not block Gazprom bid", *Energy Business Review Online*, 26 April 2006 (www.energy-

business-review.com); "Gazprom warns EU to let it grow", *BBC News*, 20 April 2006 (www.bbc.co.uk).

45 See e.g. "Undue Fears of China Inc?", *YaleGlobal*, 29 September 2005, //yaleglobal.yale.edu/display.article?id=6320 and Antkiewicz and Whalley (2005).

46 See e.g. "IG Metall and BenQ Mobile Arrive at an Agreement", *IG Metall: Siemens Dialog*¸24 September 2005, (//dialog.igmetall.de).

47 See e.g. "Indian minister in France, expresses concern at resistance to takeover bids", *BBC Monitoring South Asia,* 1 June 2006; "France's economic patriotism", *The Statesman,* 21 May 2006; "Europe's fear of pinstriped Indian", *International Herald Tribune,* 4 Feb 2006.

48 "Unions declare united front against Mittal's bid for Arcelor", *EU Business*, 1 February 2006.

49 "Politicians stop short of quashing Mittal offer", *International Herald Tribune*, 30 January 2006.

50 "Arcelor succumbs to Mittal", *Financial Times*, 26 June 2006.

51 For example, in order to allow the Committee on Foreign Investments to become comfortable with Chinese takeovers, one study suggested that Chinese companies in the United States would be wise to invest in less sensitive sectors and build a track record before moving on to more sensitive areas (Graham and Marchick, 2006, p. 107).

52 Bill S 1412 IS. See //thomas.loc.gov/cgi-bin/query/z?c109:S.1412.

53 See e.g. "Raising the red scare in India's telecom sector", *Asia Times*, 16 November 2005.

54 See "DP World and U.S. trade: A zero-sum game", *The New York Times*, 10 March 2006.

55 Unlike in the case of BITs, the share of North-North DTTs is also significant.

56 In an UNCTAD survey conducted for the *WIR06*, such diverse economies as Bulgaria, Colombia, the Dominican Republic, Mauritius, Mexico, Republic of Korea, Russian Federation, Serbia and Montenegro, Thailand, Suriname and Venezuela all stated that the conclusion of such IIAs was part of their overall strategy to facilitate outward FDI. The same is likely to apply to home countries like China, India, Malaysia and Singapore.

57 In Latin America and the Caribbean, various regional agreements have also been adopted to avoid double taxation, in 1971 for the Andean Community and in 1994 for the Caribbean Community Member States (UNCTAD 1996).

58 The calculation is based on data for nine developing economies that report outward FDI stock by destination (Hong Kong, China; India; Kazakhstan; Malaysia; Pakistan; Singapore; South Africa; Thailand; and Tunisia).

59 So far, Singapore has concluded five FTAs with other developing countries: the Republic of Korea (2005), India (2005), Jordan (2004), Panama (2006) and Thailand (2004), in addition to the Trans-Pacific Economic Partnership Agreement, which includes Brunei and Chile (2005). Furthermore, the country is planning, discussing or negotiating FTAs with, China, Bahrain, Egypt, Kuwait, Mexico, Pakistan, Peru, Qatar, Sri Lanka and the United Arab Emirates. See //app.fta.gov.sg/asp/index.asp.

60 The first wave was driven by the import substitution policies of the 1960s and 1970s.

61 In April 2006, however, the Government of Venezuela announced that it was withdrawing from the Andean Community.

62 See www.comunidadandina.org/ingles/investements.htm.

63 CARICOM is in the process of developing a regional investment policy framework, which will include, a CARICOM investment code; a harmonized incentive regime; a streamlined approval process; and the implementation of national investment policy reforms; (see www.caribbeanbusinesscommunity.com/newsletters/csm.html).

64 In July 2006, Venezuela was also admitted as a member of Mercosur, although the treaty change had not yet been ratified at the time of the publication of this Report.

65 A less extensive range of provisions was established for non-MERCOSUR investors under the Buenos Aires Protocol in 1994, which has been implemented.

66 In 2005, it was announced that COMESA would extend its membership to the Libyan Arab Jamahiriya and conclude a customs union by 2008.

67 Article 100 (h), COMESA Treaty.

68 Article 159, COMESA Treaty.

69 Article 101, COMESA Treaty.

70 Article 159, COMESA Treaty. The COMESA Treaty does not stipulate a right of admission; it is up to the member States to incorporate further investor rights in their national laws.

71 The main provisions negotiated to date include a closed-list definition that includes portfolio investment and intellectual property rights; the opening up of all economic activities and national treatment extended to COMESA investors by 2010 and to non-COMESA investors by 2015, subject to exceptions through a temporary exclusion list and a sensitive list; fair and equitable treatment; transfer of funds; national treatment and MFN treatment at the pre- and post-establishment levels; transparency; general exceptions; emergency and balance-of-payment safeguard measures; institutional arrangements; guarantees against expropriation; compensation for losses; State-State as well as investor-State dispute settlement, provisions on accession and withdrawal of members.

72 The United Nations Global Compact defines CSR as "the combined practice of implementing universal principles into business practices and engaging in partnership projects to meet broad societal goals." It emphasizes that socially responsible behaviour often requires proactive actions that extend beyond the law.

73 The UNCTAD XI conference called for pro-active policies to encourage positive corporate contributions to the economic and social development of host developing countries. Economic contributions may include investing in the poor, providing affordable goods and services, transferring technology and training personnel, building up local and cross-border value chains, fostering employment and entrepreneurship, engaging in ethical business behaviour, contributing to public revenue generation, and minimizing the negative impacts of business restructuring (UNCTAD 2005o).

74 Even more specialized treaty instruments that directly address TNCs (such as IIAs) deal very little with this issue (UNCTAD 2001).

75 According to the United Nations Special Representative on Human Rights and TNCs, there tends to be a symbiosis between "the worst corporate-related human rights abuses and host countries that are characterized by a combination of relatively low national income, current or recent conflict exposure, and weak or corrupt governance" (United Nations Commission on Human Rights 2006, para 30). Thus, weak and/or corrupt governance poses a specific challenge to the observance of CSR principles and, in particular, to the established human rights regime.

76 Surveys of managers support the impression that differences among regions and economies exist. Nearly 90% of Indian managers interviewed in a recent survey endorsed a "public good" dimension in their business dealings whereas "Chinese managers were more lukewarm." (McKinsey 2006).

77 Full text of the MNE Declaration available on the ILO website: www.ilo.org.

78 For example, the MNE Declaration calls on enterprises to contribute to the realization of fundamental principles and rights at work and to refer to the principles underpinning these for guidance in their CSR policies. These include the abolition of forced labour, equal opportunity in employment, the elimination of child labour and freedom of association, and the effective recognition of the right to bargain collectively.

79 The PRI initiative is carried out through close coordination between the United Nations Environment Programme's Finance Initiative and the United Nations Global Compact.

80 The eight performance standards define the roles and responsibilities of IFC clients for managing the social and environmental risks in their projects, and include requirements to disclose information. As well as covering new areas of risk, such as labour and working conditions and community health and safety, and an emphasis on management systems, they embody an outcomes-based approach. The full text of the performance standards and supporting materials can be found at: www.ifc.org/ifcext/enviro.nsf/.

81 See www.unctad.org/ISAR.

82 See also the 2005 United Nations Global Compact Shanghai Declaration, which argues that "[P]roactive corporate policies and practices that respect human rights and ensure safe and decent workplace conditions, environmental protection and good corporate governance create more sustainable value and benefits for workers, communities and society at large. They also enable business to attract and retain skilled workers, save costs, enhance productivity, create trust and positive reputation with stakeholders, and build brands." (United Nations Global Compact 2005, para 4).

83 See e.g. "University of California Regents vote to divest from companies doing business in Sudan", Associated Press, 17 March 2006; or "Brown University agrees to divest from Sudan", Associated Press 25 February 2006.

84 Of the 36 ATCA cases to date involving companies, 20 have been dismissed, 3 settled and none decided in favour of the plaintiffs; the rest are ongoing (United Nations 2006, para 62). In addition, the United States Supreme Court had stipulated some strict prerequisites for ATCA claims. See Sosa v. Alvarez-Machain, 542 US 692, 732 (2004).

85 Economies represented in the Asia Pacific CSR Group include: Australia, Hong Kong (China), India, Indonesia, Pakistan, the Philippines, Singapore, Sri Lanka and Thailand.

86 See, for example, the Extractive Industries Transparency Initiative, at: www.eitransparency.org.

87 Guidelines such as the *Handbook on Conflict-Sensitive Business Practices: Guidance for Extractive Industries* (International Alert 2005) or *the Global Compact Business Guide for Conflict Impact Assessment and Risk Management* (United Nations Global Compact 2002) provide practical advice. Both publications contain information on risk assessment in conflict zones and on the correct behaviour of TNCs in such areas.

88 It has been argued that "most commercial risk assessment tools are not explicitly concerned with the reverse flow of risk: the risk of a company aggravating a conflict situation" (Campbell 2002, p. 2).

CONCLUSION

During the past two decades, FDI by TNCs from developing and transition economies has expanded at an unprecedented rate. This process has been encouraged by many factors, including soaring export revenues and rapid economic growth in a number of these economies, as well as the burgeoning industrial and business prowess of their firms. Perhaps most importantly, firms from these economies have been increasingly affected by global competition. They have come to realize the growing importance of accessing international markets and connecting to global production systems and knowledge networks. Accordingly, their view of business has become far more international and their ambitions increasingly regional or global in scope. This change, from a domestic vision to an international one, underscores the nature of the structural shift taking place in the global economy.

Developed-country TNCs still provide the larger proportion of global FDI, but the rapid growth in FDI by TNCs from developing and transition economies means that some of them are emerging as major players on the world stage. Moreover, as well as being important new sources of FDI, the TNCs analysed in this report are harbingers of the future. Many firms in developing countries and economies in transition have yet to establish their first foreign affiliates, but are encouraged to do so because of the globalization processes discussed in this *WIR*, including competition with compatriot firms that have already ventured overseas. This is an exciting outlook from the development perspective, adding a new dimension to the prospects for South-South cooperation.

Developing-country TNCs invest proportionally more in developing countries than do their developed-country counterparts. For a number of LDCs, their investments account for over a half of total FDI inflows. FDI can assist host developing countries in a number of ways, including adding to financial resources and productive capacity, supporting export activity, creating employment and transferring technology. FDI by developing-country TNCs can result in proportionally greater gains, where their competitive strengths, motives and strategies differ from developed-country TNCs. For example, they are more likely to establish greenfield operations, they more commonly use standardized, non-proprietary technology, and the technological gap between local firms and their affiliates is narrower than the equivalent gap with affiliates established by developed-country TNCs. All this augurs well for South-South development cooperation, with the aim of maximizing gains and avoiding pitfalls.

The rise of TNCs from developing and transition economies is part of a profound shift in the world economy. Since its high point in the mid-twentieth century, the share of developed economies in global GDP has steadily fallen, with consequences for international patterns of trade, financial flows and investment. This process might experience the odd interruption (e.g. the Asian financial crisis of 1997), but it is now virtually irreversible.

An understanding of this dynamic phenomenon is growing, including recognition of the diverse nature and unique characteristics of TNCs from developing and transition economies, which stem from a multiplicity of origins and sources of competitive advantage. Nevertheless, because it is a relatively new phenomenon in both scope and magnitude, further investigation will be necessary to refine our knowledge, in order to help developing countries, and particularly the poorest among them, realize the full benefits of the rise of these emerging sources of FDI.