Editorial statement

Transnational Corporations (formerly The CTC Reporter) is a refereed journal published three times a year by UNCTAD. In the past, the Programme on Transnational Corporations was carried out by the United Nations Centre on Transnational Corporations (1975–1992) and by the Transnational Corporations and Management Division of the United Nations Department of Economic and Social Development (1992–1993). The basic objective of this journal is to publish articles and research notes that provide insights into the economic, legal, social and cultural impacts of transnational corporations in an increasingly global economy and the policy implications that arise therefrom. It focuses especially on political and economic issues related to transnational corporations. In addition, Transnational Corporations features book reviews. The journal welcomes contributions from the academic community, policymakers and staff members of research institutions and international organizations. Guidelines for contributors are given at the end of this issue.

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**RESEARCH NOTE**

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This paper reviews successive editions of the World Investment Reports (WIR) from UNCTC and then UNCTAD over the period 1991–2010. The 20 WIRs present an excellent overview of changing perspectives of key aspects of interaction between transnational corporations (TNCs) and development. Successive WIRs have reflected and have helped to create paradigm shifts in our understanding of the complex relationships between TNCs and development. A number of WIRs have helped the academic and business communities to focus on particular aspects of TNC activity, types of TNC or emerging phenomena in the global economy. Their continuing re-evaluation of the development impact of changing TNC structures, strategies and modes of operation has helped to shape the intellectual landscape and policy prescription towards TNCs. Through the WIR, UNCTAD has been able to influence policy towards TNCs and development in many domains, many host and source countries and at the international level. The content of the 20 WIRs represents a considerable intellectual achievement.

1. Introduction

After 20 years of producing the WIR, now is an opportune time to review the contribution of this important publication. As well as the Reports, the United Nations Conference on Trade and Development (UNCTAD) has also created a world-class database, a number of associated publications and bulletins and a network of research partners across the globe.


This was against a background of turbulence at UNCTAD and the UN. UNCTAD was struggling to develop a “code of conduct” for TNCs (Sagafi-Nejad and Dunning, 2008; Moran, 2009) and in 1992–1993, activities related to transnational corporations (TNCs) moved from New York to Geneva.
Moran’s (2009) review of Sagafi-Nejad and Dunning (2008) suggests that the book understates the importance of TNC-related endeavours at the UN. He also claims that the UN has been crucial in shaping understanding of the relationship between FDI and sustainable development. Indeed, Moran characterizes the early period of the UN’s work on TNCs (1972–1992) as “an era of misdirection” (2009, p. 92). The end of this period coincides almost exactly with the first **WIR**: “From 1972 to 1992, unravelling how various forms of FDI might affect development and what was the most useful host policies might be was a work in progress” (2009, p.96). Moran characterizes the positive steps that the UN then took as “helping to guide a paradigm shift” (2009, p. 97).

2. The **World Investment Report from 1991 to 2010**

The first **World Investment Report** was published by the United Nations Centre on Transnational Corporations (UNCTC), in August 1991. Its preface announced it as “the first in a series of annual reports which will present data and trends relating to transnational corporations and foreign direct investment”. In addition, each volume would focus on a topic which emerges from the Centre’s ongoing research activities (**WIR 1991**, iii). This promise has been kept.

**WIR 1991** pointed out that foreign direct investment (FDI) had been increasing far more rapidly in the 1980s than both world trade and world output, and this promised to continue into the future. Chapter I of the report covered “Global Trends in Foreign Direct Investment” and examined the increasing importance of FDI in the 1980s, its regional distribution, sectoral pattern, and policies affecting FDI. Data were very limited and outflow data were given for only the five major home (source) countries (France, Germany, Japan, United Kingdom and United States) and for the host regions and the ten largest developing countries (tables 3 and 4). The sectoral breakdown was given only for “services” and “non-services” for the five major outward investors (Table 6), although Table 7 gave a breakdown of stock estimates of outward FDI by primary, secondary and tertiary sectors for seven countries (adding Canada and the Netherlands). Services had already been identified as a central component of FDI stocks and flows.
The special subject of *WIR 1991* was identified in Chapter II as “Pattern of FDI in the Triad” (defined as “the United States, the European Community and Japan”). Intra-Triad FDI was illustrated in the justly famous, and much copied figure II (p. 20) which illustrated, by the thickness of its lines, the strength of intra-Triad flows of FDI. This showed dramatically the strong FDI links (two-way) between the then EC and the United States; the strong Japanese FDI in the United States; the weak FDI links between Japan and the EC; and the miniscule nature of FDI into Japan. *WIR 1991* was further innovative in exploring the regional networks of TNCs, with particular emphasis on Japanese firms. An early examination of these networks brought out the complex international network (supply chain) of Japanese car companies – examining in detail the automobile operations of Toyota (figure VIII, p 62).

*WIR* went on to identify FDI “clusters”, where Triad members dominated host countries. This showed a general United States dominance of Latin America, Japanese dominance in Asia and

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**Figure 1. Intra-Triad foreign direct investment, 1988**

![Diagram](image_url)


*Note:* Dollar figures show 1988 outward stock; percentages show average annual growth rates, stocks and flows. Stock growth rates are for the period 1980 to 1988. Flow growth rates are for the period 1985 to 1989. The data for United States outward and inward stocks in and from the EC and Japan include reinvested earnings.
EC dominance in “Eastern Europe”. This insightful picture of the international economy (figure VII, p. 56) was then developed in Chapter III, “Interlinkages”, examining FDI and international trade, TNCs and technology transfer, TNCs and financial flows, and a summarizing section, “The integrating agents: transnational corporations”. This final section demonstrated the importance of TNCs and their strategy in the configuration of the international economy. It illustrated the centrality of FDI tying together exports, technology and financial flows by the integrating agency of the TNCs. The linkages between these major flows were implicitly seen as a future research agenda.

The final chapter on policy implications examined the governance of TNCs from both national and multilateral standpoints, but went further than was then conventional by linking Triad dominance of ownership of TNCs to policy, by putting the interlinkages centre-stage. WIR 1991 was a very promising start to the series, laying down markers to originality, policy relevance and insightful analysis.

The second in the series, WIR 1992, subtitled “Transnational Corporations as Engines of Growth”, announced its raison d’être in the first line of the Introduction: “Transnational corporations have become central organizers of economic activities in an increasingly integrated world economy” (p. 1). The Report recognized that FDI figures (the subject of Part I of the Report from this point on) did not represent
the full extent of the activities of TNCs. It recognized that flows of technology (paid for by transfer prices set intra-firm), R&D and “soft technologies” (i.e. know-how, training and organizational skills) are also vitally important to development and to development policy. Despite the fact that most FDI (between two-thirds and three-quarters over the entire period covered by WIRs) flows between developed countries, the impact of FDI and TNCs on less developed countries is critical. FDI is likely to represent a larger share of their capital formation, even where it is small in absolute amounts, than that going into a typical developed country. Clusters of FDI were also identified, and linkages placed centrally to the analysis of external impact.

Five key trends underlay the “engines of growth” idea.

1. An increasing emphasis on market forces and a growing role for the private sector in nearly all developing countries.

2. Rapidly changing technologies that are transforming the nature of international production and the organization and location of such activity.
3. The globalization of firms and industries whereby production chains span national and regional boundaries.

4. The rise of services (the theme of *WIR 2004*) to become the largest single sector in the world economy.

5. Regional economic integration.

TNCs are at the centre of all these trends and are setting new policy agendas for developing countries. *WIR 1992* was comprehensive in the range of contributions that it perceived TNCs to have on development. FDI contributes to capital formation particularly in technology-intensive industries. Frequently this brings new plant and equipment, which enhances productivity and can induce demonstration and learning effects, as well as increasing competition. Technology transfer was singled out as most likely to have the greatest growth-inducing effect. Trade effects and access to markets are likely to increase exports and training, and environmental standards are likely to be improved, giving rise to sustainable long-term growth effects. The key analytical point of *WIR 1992* is that these elements come as a package of tangible and intangible assets (the (foreign) control of this package was, perhaps, a little underemphasized). It was suggested that the policy response needed to be both coordinated and holistic, and that policies in developing countries needed to be redefined and broadened.

In a sense, *WIR 1992* set an agenda for future *WIRs* and for policy and policy analysis that would prove enduring. It provided a framework for understanding the interactions between the various aspects of TNC policies, and showed that a comprehensive policy response was required from developing countries, if they were to maximize the potential benefits. Minimizing the downsides of TNC policy largely remained unanalysed at this stage. Intriguingly, *WIR 1992* also points to the policy requirements on outward FDI – “little is being done to promote outward investment beyond insurance and protection guarantees” (p. 7). This was to remain a key mantra for many years. In a similar vein, calls for a more comprehensive international governance framework for TNCs to keep pace with rapid globalization become a regular feature of *WIRs*. In some sense, perhaps unfairly, *WIR 1992* may be labelled as a “Washington Consensus-friendly” document.

*WIR 1993* was a logical follow-up to its predecessor. It is subtitled “Transnational corporations and Integrated International Production”,

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and considered the strategies and organization of TNCs to be leading to systems of integrated production worldwide. The public policy issues arising out of this were identified as the resolution of “corporate nationality”, parent-affiliate relations and responsibilities, tax issues and investment policies.

**WIR 1993** took on board the vast range of functions carried out by TNCs and resolved their varying strategies into “stand alone strategies, simple integration strategies and complex integration strategies” (pp. 115–125). Complexity in integration arose from developments in information technologies enabling coordination to be carried out more widely (and deeply) by TNCs, demand structures (convergence across countries versus differentiation) and intensified competition. Organizational structures of TNCs, too, were evolving. Intra-firm structures allowed greater functional specialization and devolution of decision-making power down to lower units within the TNC. This may be achieved by product-line functional or regional “headquarters”. Inter-firm structures centred on a web of strategic alliances, and the emerging network structures were traced as components in the emerging globally integrated production system. Examples were taken largely from the car industry, with extensive case studies of Ford and Toyota.

**WIR 1994** tackled a hugely important topic – the relationship between TNCs and labour. This edition, subtitled “Transnational Corporations, Employment and the Workplace”, covered employment (Chapter IV), human resource development (Chapter V), and industrial relations (Chapter VI). Policy issues arising were liberalization of FDI policies (Chapter VII), corporate social responsibility (CSR) (Chapter VIII), trade union approaches to international production (Chapter IX), and government policies, human resource development and TNCs (Chapter X). The organization of labour markets are clearly affected by globalization and the policies of TNCs both quantitatively (the proportion of a country’s workforce employed by foreign (and locally owned) TNCs) and qualitatively (impact on working conditions, human resource development, industrial relations practices). TNCs also create an internal, transnational labour market with implications both for directly employed workers and for the organization of labour across countries. Unions and host country governments are not necessarily
united in their reactions to TNCs and globalization of internal labour markets, and so a uniform host country response cannot be assumed.

Rising unemployment (as in 1993) focused attention on TNCs’ policies, particularly relocation of activity, and therefore employment, between countries. Competition for FDI between potential host countries for footloose projects can benefit TNCs at the expense of labour (but not necessarily workers in countries with successful attraction policies). The danger of a policy “race to the bottom” is acknowledged in the Report.

In anticipation of \textit{WIR 1995}, the 1994 Report sees competitiveness and created assets (in the host country) as the key to improving employment in developing countries (pp. 246–247). TNCs can upgrade labour skills and seek out well trained, well educated and flexible workers. The “complex integration strategies” (p. 247) of TNCs require increased skills and training, and in order to benefit from linkages and spillovers, the labour force external to TNCs must be similarly equipped. Linking into “TNCs value chain” (p. 247) is seen as a vital element in upgrading human resources.

Chapter VI opens with: “Industrial relations in TNCs are going through a period of great change”. Locational flexibility puts a question mark against demands for union recognition, the effectiveness of union action, and access of unions to decision-makers. Concerns are expressed by unions not only on the remoteness of top management in TNCs but also on information disclosure and consultation. TNCs have a track record of introducing innovatory practices – independent bargaining, flexible organization of activities included – and these are not always welcomed by labour organizations. Against a background of general FDI-related policy liberalization, Chapter VIII (which includes a fascinating but short review of “the principle of subsidiarity”, Box VIII.1, p. 315) places more emphasis on CSR in TNCs. This is an excellent discussion of the emerging topic. Chapter IX examines trade union strategies to the rising dominance of TNCs – the collection and exchange of information, “demonstrating international solidarity” and moves towards transnational bargaining. The arena of international guidelines is explored for international labour standards. In recent years such issues as “sweatshops” have come under increased scrutiny, although these phenomena are more serious in outsourced and
offshored facilities which TNCs do not actually own (though they must acknowledge control and responsibility), rather than in internalized employment.

In Chapter X, Government policies are seen as utilizing TNCs to improve human resource development by enabling policies on training, upgrading and enlightened employment practices. Encouraging forward and backward linkages enhances these processes. There is little on restricting the downside of some TNCs’ operations, or on coercive policies to encourage employment protection or prevent divestment. This intellectually and socially challenging issue is surely in need of revisiting, in the light of changes brought about by globalization, new employment practices and the moves of TNC away from internal labour markets to outsourced and offshored facilities, with radically different implications for labour.

The theme of *WIR 1995* was “Transnational Corporations and Competitiveness”. Competitiveness was a term in vogue at that time, following the success of Michael Porter’s (1990) book, *The Competitive Advantage of Nations*. Porter had shifted the emphasis of policy away from dynamic comparative advantage, a concept largely applied at country level, to the industry level, localized clusters of companies and company strategy based on internalized competitive advantages. This formulation raised many policy issues, notably the ideas of building clusters of companies within countries, creating internationally competitive champions and possibly nurturing TNCs of the host country’s national ownership. As with many other questions, competitiveness is not a completely transparent concept (Buckley, Pass and Prescott, 1990) as it raises the “Who is Us?” question (Reich, 1990). Is it in a country’s (competitive) interest to foster and protect all firms within its economic space, or should policy focus on encouraging companies owned by the host country wherever they operate? Is it the interests of the geographical “country”, or that country’s ownership of TNCs (and their precious internalized advantages), that should be the focus of national policies? The answers to these questions profoundly affect the international outcomes of “domestic” policies and require careful reformulation of the international policy architecture.

*WIR 1995* examined “FDI, firm competitiveness and country performance” under the following headings: access to resources,
expanding market access, and TNCs and economic restructuring. “Resources” were divided into capital, technology, innovatory capabilities and skills, organization and managerial practices. All these key resources are analysed from the point of view of the generation of competitive advantages – for TNCs who raise and disburse capital, generate new technology which often spills over to local firms, and develop new management and organizational practices which engender efficiency and competitiveness. Chapter II of *WIR 1995* is an extremely rich and powerful analysis of the generation and use of competitive advantages of TNCs. Chapter IV, “Expanding Market Access”, is also conceptually rich. It analyses internal markets in TNCs (pp. 192–197) and contrasts this with external markets (pp. 197–209) in classic Coasean fashion (Coase, 1937). This allows a careful consideration of linkages and spillovers outside the firm, and the use of intra-firm transfer pricing as key outcomes of TNC internalization of intermediate markets in goods, services and knowledge. Implications are drawn for both inward and outward FDI.

Chapter V tackles the most important aspect of this analysis for development – the ways in which TNCs, in building a portfolio of internalized assets for their own competitiveness (profits?), can contribute to the restructuring (improvement in development terms) of individual developing economies. Here, the focus shifts from competitiveness to productivity, which many economists would claim is a more tractable and meaningful concept. Words such as “restructuring” “revitalizing” “upgrading” are used at various points to convey the impact of TNCs on developing countries. Generally, the conclusions are that when TNCs improve their own competitiveness, they also contribute to the restructuring of economies at different stages of development. This depends on local conditions too, of course, and appropriate policies. Policy implications are outlined in Part Three, Chapter VI examining inward FDI and Chapter VII Outward. Chapter VI covers attracting and retaining FDI, facilitating the transfer and diffusion of technology and encouraging the acquisition of skills to mirror the earlier analysis of competitive advantages. As usual, incentives to inward FDI are not found to be the main determinant of locational decisions in TNCs. However, the chapter is missing a more in-depth examination of the key issue that TNCs wish to actively discourage spillovers and diffusion of technology, which host countries see as major advantages of inward FDI, and this perhaps represents the major lacuna in the
analysis of the competitiveness agenda and development. Chapter VII on outward FDI policy contrasts regulatory policies with promotional policies. Caution in policy development is counselled, but there is a theme in this chapter that, in certain circumstances, outward FDI need not be bad, and that it might even benefit the competitiveness of (Southern) TNCs and thereby enhance the development of the source country. This theme was to be pursued powerfully in \textit{WIR 2006}.

\textit{WIR 1995} is conceptually rich, intellectually challenging and carefully worked. It explores the notion and impact of “competitiveness from many angles” and is “all of one piece” conceptually. The flaws of the concept of competitiveness are inadequately explored, as are the links between the pursuance of competitiveness and development. Nevertheless \textit{WIR 1995} is a most impressive cooperative intellectual achievement.

\textit{WIR 1996} (“Investment, Trade and International Policy Agreements”) focused on the links between FDI and trade and examined the possibility of a multilateral agreement on FDI. Trade and FDI links were examined as a sequential process. FDI was felt to generally lag trade both in manufacturing and in the form of imports in extractive industries. This sequence was truncated in the case of services. Intersectoral and indirect effects complicate the relationship between trade and FDI. The general trend identified is that “first, trade eventually often leads to FDI; and second, that, on balance FDI leads to more trade” (p. 91). Liberalization and globalization have led to these relationships becoming subsumed into the issue of why TNCs locate activities in particular geographic spaces. The links between these “nodes” of TNC activity are then resolved into trade or FDI which are “simultaneously determined” (p. 120). A long and interesting Annex examines “Integrating the theories of FDI and trade” (pp. 123-125). It is the integration of FDI and trade that requires coordinated policies and makes international (multilateral) agreements on FDI “prominent” (p. xxvi).

\textit{WIR 1997} was subtitled “Transnational Corporations, Market Structure and Competition Policy”. This report contains a chapter (Chapter III) on foreign portfolio equity investment that trawls through the types of portfolio foreign investment and mentions links with FDI. In the absence of any overarching or combining theoretical framework,
this does not go very far, but this is an area well worth revisiting in today’s post-credit crunch world.

Because of its topic, WIR 1997 is based on more orthodox economic analysis than most. FDI has the potential to increase competition and the contestability of markets, but the entry of TNCs into protected and unliberalized markets may well lead to a dominant or monopolistic situation. WIR 1997 contains careful and interesting analyses of market competition and performance (Box 1, pp. 125–126) and contestability (Box 2, p. 127), together with the links between competition, development and (the crucial role of) competition policy (Box 3, p. 131). Entry barriers, to both domestic and foreign firms are crucial, and policy can remove some of these and encourage competitive behaviour. Anticompetitive behaviours are identified in the Report as including collusion, monopolizing acquisitions, exclusionary vertical practices, predatory behaviour and predatory pricing (pp. 156–158). The practice of offering market protection in order to encourage inward FDI is analysed, documented and condemned (pp. 159–163).

However, “the relationship between FDI and market concentration in host countries is by no means as clear-cut as the observed correlation between TNC presence and concentration might suggest” (p. 148). The emergence of global and regional markets and integrated production in TNCs mean that competition must be examined as a dynamic phenomenon and there may be a (very restricted) case for protection of sectors that have not yet built up capabilities but have the potential to do so.

WIR 1998 had the uninspiring subtitle “Trends and Determinants”. Its publication followed the Asian currency crisis of 1997. Time was to show that FDI was affected less than other capital flows – largely because of its longer-term nature – and this was apparent even in the fairly immediate aftermath of the crisis. Indeed, WIR 1998 points out that the crisis might even prove to be conducive to increasing FDI through its M&A mode, as the cost of acquiring assets declined. Such an outcome would depend on TNCs taking a long-run view of the prospects of the host country. Cost competitiveness also is likely to improve in these circumstances. The dispersion of outward FDI is likely to change as outward investment from the affected countries falls and foreign TNCs take advantage.
The policy analysis in *WIR 1998* suggested that national FDI policy frameworks – described as a “necessary but not sufficient determinant of FDI location” (p. xxvi) – are becoming relatively less important with liberalization and globalization. *WIR 1998* resurrected the idea of a multilateral framework on investment (MFI) as a response to globalization and the transnationalization of business. So far, this proposal has come to no practical resolution.

*WIR 1998* also emphasized “created assets” as a source of competitiveness enhancement and therefore increased FDI. This was an early indication of the train of thought that led to intangible assets as a key element in the analysis of TNCs and to the addition of “strategic asset seeking” as a fourth motive to add to the three primary motives: market seeking, resource seeking and efficiency seeking, analysed on pp. 183–189.

*WIR 1999* conveys the notion of taking stock (or indeed of marking time). It purports to examine “Foreign Direct Investment and the Challenge of Development”, and therefore has a less clear focus than other Reports. Financial resources and investment, enhancing technological capabilities, boosting expert competitiveness, generating employment and strengthening the skills base are all traditional FDI and development issues that are revisited together with “the new competitive context” and the social responsibility of TNCs as emerging areas of interest. The generality of the Report is perhaps explained by UNCTAD X in Bangkok\(^1\) and the UN Millennium Summit and Assembly in New York. This Report was always likely to be overshadowed by the development of the Millennium Development Goals developed in 2000. It is a workmanlike trawl through the key issues and plays a role as a benchmark in examining FDI and development, but it is conventional in subject and outlook. The Annex to Chapter XI, “The impact of FDI on growth: an econometric test”, is a worthwhile effort and served as a state-of-the-art study.

“Cross-border Mergers and Acquisitions and Development” was the subtitle of *WIR 2000*. This Report highlighted the crucial (and often forgotten) fact that most FDI takes place in the form of M&As. In fact “mergers” – the coming together of equals to form a

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1 The Tenth Ministerial Meeting of the United Nations Conference on Trade and Development.
new firm – are a vanishingly small proportion of M&As (Buckley and Ghauri, 2004). Acquisitions, therefore are the dominant mode of FDI. This raises all kinds of policy issues for both host and source countries. Blithe talk about increasing FDI inflows in practice translates as “sell local companies to foreign buyers”. The promotion of inward FDI by encouraging foreign acquisition remains controversial in all countries and is a complete non-starter in many. Similarly, outward FDI is often in the form of buying foreign companies, and policy-makers and civil society generally may argue that such “predatory behaviour” should be discouraged in favour of domestic investment.

_WIR 2000_ was well-timed. Given the cycles of “boom and bust” in M&A activity, 2000 coincided with an upsurge in international M&As. “Over the past decade, most of the growth in international production has been via cross-border M&As rather than Greenfield investment” (p.10). Part of the Report (Chapter V) examined historical parallels.

Mode of entry _does_ matter. Chapter VI of _WIR 2000_ examines this proposition. A detailed and generally careful analysis, well supplemented by case studies, shows that the choice of entry mode is crucial in determining the development of effects of FDI via the impact on financial resources, technology, employment (and skills), export competitiveness and trade and market structure and competition. The Report points out that the time profile of the impact differs between greenfield ventures and acquisitions. There are more obviously negative short-term economic and political effects of acquisitions, but in the long run, benefits (via the infusion of intangible assets) may be great. There are, however, deep-seated worries about the adverse effect of foreign acquisitions by “the weakening of the national enterprise sector and a loss of control over the direction of national economic development” (p. 198). This is particularly the case where industries “thought to be strategic” (p. 198) come under foreign control.

Policy issues on foreign M&As are difficult to disentangle from M&As in general. The danger of restricting (foreign) M&As is that this may encourage anti-competitive behaviour. Restricting M&As is likely to affect all forms of FDI. Policy needs to steer a careful course between protection of key national assets (and their definition) and overly restrictive actions.
WIR 2000 says little about outbound M&As, but it is an exemplary WIR; tackling a key issue of globalization and relating it to development.

“Promoting Linkages” was the stark subtitle of WIR 2001. The theme of integrated international production implies that key influences on development arise from the generation of linkages in host countries with TNC-driven integrated production systems. The Report identified backward linkages as potentially important channels through which intangible and tangible assets can be absorbed into the domestic sector. This can potentially have the effects of (1) upgrading local enterprise and (2) embedding affiliates of TNCs more firmly into the local economy. Policies to encourage TNCs to increase their local purchasing and to enable local enterprise to supply the required inputs (which means upgrading in terms of quality, knowledge and resource exchange between TNCs and local firms and training) are detailed in the Report. Linkages developed in highly protected regimes are unlikely to be sustainable and the bargaining relationship between TNCs and local suppliers is likely to be asymmetric in terms of power. Promoting linkages and clusters of suppliers is therefore a more subtle and multifaceted strategy than simply establishing export processing zones or “science parks”, and requires thorough rethinking and restructuring of the domestic sector. Policies also need to be flexible, as an agile, dynamic local supply system will be needed if it is to contribute to sustainable long-run development. Information exchange is crucial in this process and WIR 2001 pays attention to institution-building that brings (international) buyers and (local) sellers together on a secure footing. Special linkage programmes are advocated in detail.

WIR 2001 introduced a new index – the Inward FDI Index – intended to capture the ability of a country to attract FDI after accounting for size and competitiveness. Technically, it was an average of the share of the country in world FDI, relative to its shares in (1) GDP, (2) employment and (3) exports.

“Transnational Corporations and Export Competitiveness” was the subtitle of WIR 2002. The role of TNCs’ international production systems (see WIR 1993) was seen as essential in improving the export competitiveness of developing countries, and improved export competitiveness was seen as a key influence on development. UNCTAD was therefore building a comprehensive analysis of the relationship
of global value chains to development. **WIR 2002** encountered the dilemma of developing countries (and firms from those countries) as to whether to collaborate enthusiastically with TNCs or attempt to upgrade technology, skills and marketing in competition with TNCs. Export-orientated products can of course be organized within TNCs or in competition with them. This is complicated by the need (acknowledged in the 2002 Report) that export competitiveness also depends on access to high-quality imports that are often under the control of TNCs.

The “export competitiveness challenge” is not therefore just a question of developing export incentives (subject to WTO rules, of course), infrastructure and training, but also necessitates cluster development, often around key foreign-owned subsidiaries or affiliates of TNCs. Using TNCs as growth poles is a major component of export-driven development, but does this preclude the independent development of national exporters?

Policies recommended are investment and business promotion in a targeted fashion, institution-building designed to foster successful agglomeration and training, and upgrading of human resources. It must be acknowledged, however, that those host countries that attract (and set out to attract) FDI from TNCs will be implementing different strategies from those that cannot (or do not wish) to attract TNCs. A comparison of with/without FDI was perhaps needed – and still is needed.

**WIR 2003**, subtitled “FDI Policies for Development: National and International Perspectives”, concentrated on policies to enhance the development dimension of international investment agreements (IIAs). It was concerned largely with the minutiae of IIAs. The first chapter in Part Two (Chapter III) examined the relationship between national FDI policies, development goals and IIAs. Chapter IV identified eight key issues of IIAs: the definition of investment, “national treatment”, nationalization and expropriation, dispute settlement, performance requirements, incentives, transfer of technology and competition policy. The objectives, structure, content and implementation of IIAs was the subject of Chapter V whilst home country measures and “good corporate citizenship” were analysed in Chapter VI. Thus, the emerging concept of CSR was reintroduced into **WIR**.
**WIR 2003** is unusual in concentrating heavily on the legal dimension of FDI and the details of IIAs. It perhaps did not link this closely enough with the development impact of the provisions of IIAs. This would have required rather more probing of the effective implementation of the agreement and the change in behaviour of TNCs (if any) that the IIAs brought about.

**WIR 2004** took as its subtitle “The Shift Towards Services”. FDI in services had been a neglected subject, and the paradigm for FDI and TNCs had been largely derived from manufacturing industry. The shift towards services was examined in a chapter on the growth of FDI in services and its implications. “The next global shift?” was projected to be the offshoring of corporate service functions. Host country policies on FDI in services were felt to be the key to positive development effects, although **WIR 2004** foresaw challenges in host country policies in adapting to FDI in services.

FDI in services accounted for only one quarter of the stock of world FDI in the early 1970s, but by 1990, it had risen to one half, and by 2002 to 60%. Over this longer period, world FDI stock in manufacturing fell from 42% to 34%, and in the primary sector from 9% to 6%. The composition of FDI in services also shifted – trade and financial services fell from 65% of world stock in 1990 to 47% in 2002. Electricity, water and telecoms services (later to be the subject of **WIR 2008**), together with IT-enabled corporate services, were the big gainers. FDI stock in electric power and distribution grew fourteen-fold, telecoms storage and transport sixteen-fold, and business services nine-fold. **WIR 2004** identified a definite structural shift in FDI which reflected, in turn, a change in the strategy of TNCs. Following the theme of **WIR 1993**, TNCs were beginning to deploy location policies (including offshoring) and externalization strategies (outsourcing of services) by fine-slicing their activities and optimizing location costs and ownership strategies in newly emerging, global deployments. Services require a large variety of modes of operation to penetrate global market niches, and **WIR 2004** found M&As and non-equity arrangements to be important strategies in establishing integrated service networks by TNCs. A further complexity is the existence of specialist TNCs in services together with the wide range of services produced by non-service TNCs. This complicates policy and the role of international investment agreements (IIAs) in services.
**WIR 2004** (Box 1, p. XXV) made a distinction that many writers on FDI and TNCs still fail to recognize – that between offshoring (a location decision) and outsourcing (an externalization decision), by distinguishing between captive and outsourced offshore plants.

**WIR 2004** was also the first digital **WIR**, coming with a CD attached to the inside cover.

**WIR 2005** ("Transnational Corporations and the internationalization of R&D") examined a key phenomenon underlying the growth of TNCs: research and development (R&D). It was dedicated to the memory of Sanjaya Lall who had worked on this area and been a major contributor to UNCTAD’s work.

**WIR 2005** examined R&D, innovation and development. Against the basic finding that R&D is geographically concentrated (Chapter III, B2), R&D by TNCs is shown to be internationalizing (Chapter IV, B) – a growing share is undertaken abroad. There is a difficult distinction between the “R” (basic research) and the “D” (which could include local adaptation of basic ideas), and this is problematic to disentangle. An interesting issue is the increasing outsourcing of R&D (Chapter V, pp. 168–170) and its decentralization. “Closed” to “open” innovation is a related concept, analysed here for the case of IBM (Box V.6, p. 169). Make-or-buy decisions in R&D also received separate treatment (Box V.7, p. 171), identifying *inter alia* the tacit aspect of the knowledge, the relatedness of the R&D to “core advantages”, need for specialized skills and equipment (specific assets), rapidity of innovation and, of course, cost-cutting. Despite all this, the Report concludes that “the main driver for R&D internationalization by TNCs remains the need to adapt products and processes to conditions in host country markets” (p.172). “D” rather than “R”! However this is followed by a long case study, “The Rise of Chip Design in Asia: A Case Study” (Annex to Chapter V pp. 173-176) which suggests that “innovative R&D” is migrating to developing countries (p. 173).

The policy section perhaps underplays the desire of host countries to attract TNCs and FDI in R&D activities. The ability of modern TNCs to “fine-slice” their activities and to locate and control each slice in the optimal way means that R&D units are the object of intense competition around the world. As (generally) non-polluting, high value added activities, such units are the object of intense competition...
from potential host countries wishing to attract R&D facilities. This is a different type of competition from general strategies to attract FDI – often based on employment creation or protection – and is carried out by a smaller number of players. Indeed, some countries (e.g. France) specialize in the attraction of these desirable “catches”.

There is a great deal of content in WIR 2005 that is perhaps not fully resolved into effects or policy outcomes. This is definitely a subject worthy of revisiting.

WIR 2006 has a good claim to be one of the most path-breaking. It took as its subject “South-South” FDI (“FDI from Developing and Transition Economies: Implications for Development”). Chapter III, “ Emerging Sources of FDI”, which analyses global and regional TNCs from the South, describes South-South FDI. Fortunately, and correctly, “Southern” TNCs were seen as special cases in the theory of TNCs, rather than being seen as requiring new theory. However, the theory was applied in an imaginative fashion. John Dunning’s hand can be seen in the conceptual structure of Chapter IV “Drivers and Determinants”, where “the types of advantages possessed by developing country TNCs” (Table IV.1) and the “investment development path” (IDP) are invoked as conceptual underpinnings. It is, perhaps, Chapter III that epitomizes WIR at its best. “Emerging sources of FDI” is a thorough, careful and conceptually sound analysis of the “new” phenomenon of Southern originating FDI. Trends, M&As, sector analyses (showing the importance of services), interregional flows and network structures are embedded in that rare thing – a structured and detailed, analytically driven description of a significant empirical phenomenon. The analysis of global and regional Southern TNCs continues this analysis and highlighted, possibly for the first time, the importance globally of Southern TNCs by sector (Table II.14, p. 123). Case studies of Orascom, Samsung, Temasek, Huawei, Infosys and others give real world “bite” to this analysis.

This is an outstanding example of UNCTAD’s WIR, not only reflecting a real empirical phenomenon, but advancing understanding of the phenomenon, the conceptual framework and insightful analysis leading to improved policy outcomes.

WIR 2007 was the first of a series of three Reports concentrating on particular sectors in the global economy – extractive industries,
infrastructure and agriculture. *WIR 2007*, subtitled “Transnational Corporations, Extractive Industries and Development”, examined a strangely neglected area of TNC research. Extractive TNCs had been closely examined in the 1960s and 1970s (e.g. Vernon, 1971), but seemed to have slipped the net of later theorizing. Traditionally, extractive industries have been a major source of conflict, possibly the major source of conflict, between TNCs and governments (compare efficiency- and market-seeking motives to resource-seeking). Minerals are, the report points out, essential for all economies, and as such enter the value chain at an early stage (value chain analysis is not well developed in the Report – contrast *WIR 2009*). Key issues developed here are (as always) the division of returns between TNCs and host countries, the commodity boom and environmental impacts.

*WIR 2008*, “Transnational Corporations and the Infrastructure Challenge”, covered a vital area for all economies, underpinning economic activity, development and growth. The modalities of TNC involvement in infrastructure were said to be “determined by three factors: their competitive advantages, the degree of risk of a particular project and host government objectives and policies” (p. 117). The Report identified an “infrastructure gap” in developing countries, partly a financial gap but also a technical and informational gap, which TNCs can potentially fill (pp. 92–94). Infrastructural problems have been identified as major constraints on development in countries such as India, and the Report examines the extent to which TNCs can help to release these constraints. Southern TNCs are shown to be major players internationally (as with extractive industries in *WIR 2007*, and agricultural TNCs in *WIR 2009*).

Key sectors in infrastructure are water, electricity, transport and telecommunications. The first two are vital for health and security, and issues of charging for basic supplies – particularly of water – are emotive and are often inhibitors of investment (for profit or simply to ensure some contribution to costs). In view of this, Chapter V on “Policy Challenges and Options” is unusually open and discursive. Some sectors (e.g. water) are highly restrictive to TNC entry (particularly by FDI), whereas most countries allow FDI in telecoms. Even within a sector like transport, roads are more open to foreign involvement than in rail. The strategic element and social objectives restrict openness and the perception of these objectives differ by sector and by country.
In *WIR 2008*, FDI by sovereign wealth funds (SWFs) was identified in a separate section of Chapter I. This became FDI by special funds in *WIR 2009*, when FDI by private equity funds was added.

*WIR 2009*, “Transnational Corporations, Agricultural Production and Development”, tackled a difficult subject. Agricultural TNCs, in the sense of firms owning agricultural production in foreign countries, are relatively rare, and it is through supply chain effects that the impact of TNCs is largely felt. The by-line of Chapter III Part C1 sums it up: “Historical developments: from plantation to value chain coordination”. Nevertheless, the issues of contract farming, the “food crisis” and the emergence of state or quasi-state SWF foreign direct investors together with the associated issues of water shortages, “land grabs” and “food security” make this a lively issue.

Agriculture is of fundamental importance to development, and FDI in agriculture is thus of compelling interest. Despite this, *WIR 2009* points out, there has been a chronic neglect of agriculture in many countries. This has important negative effects, not only because of the importance of agriculture in its own right but also because of its interdependence with other sectors, notably manufacture. The vulnerability of agriculture to (regional) conflict, its direct impact on poverty and hunger and its strategic political salience makes policy decisions (toward FDI) of vital interest. There are also geopolitical dimensions arising from the “food crisis” and concerns about “land grabbing”.

*WIR 2009* takes UNCTAD’s usual stance – analytical, objective and fact based – together with a pro-development policy advocacy which steers the Report around some of the wilder speculation in this area. The diversity of the industry is recognized, as are the implications of value chain links, the importance of inputs, particularly water, is emphasized as a key influence on policy outcomes, and the importance of technology and R&D is given due prominence. Food security concerns and the conversion of output to biofuels have to be factored into rising concerns on protectionism in agriculture. All of these factors have strong implications for TNCs and indeed are driven by TNCs. *WIR 2009* unravels this complex causality not only by examining flows of FDI, but also by focusing on TNCs at different stages of the value chain. Figure IV.I (p. 134) explicitly models the activities of TNCs along agribusiness
value chains and the types of impact that result in host developing countries. The roles of TNCs in financing agricultural investment, in providing technology, in facilitating market access, and in training, employment and skills are analysed in addition to the direct operations of TNCs and their role in commercialising agriculture. These effects, intended and unintended, are not always positive – or positive for all sectors of society – as the Report shows.

The involvement of TNCs in agriculture is well summarized in Figure III.4 (p. 110). After splitting off arm’s-length trade, TNCs are involved in FDI, management contracts and licensing, contract farming and standards and specifications.

Agriculture-based TNCs – or TNCs in the agricultural production part of the value chain – are shown to be small in output terms (pp. 123–125), but TNCs are significant in all other parts of the value chain, suppliers of equipment and inputs (including fertilizers), manufacturing and processing, retailing/supermarkets and trading/wholesaling.

Agriculture therefore is a powerful illustration of the importance of TNCs through their control of the value chain. (Buckley, 2007, 2009; Buckley and Ghauri, 2004). Knowledge of key interventions (new crops, techniques, fertilizers) and of key markets (through the immense informational resources of supermarkets) is central to TNC power, and these factors are expressed through non-equity forms, not FDI. This is the major theme of *WIR 2011* (forthcoming).

*WIR 2009* has led to a continuing involvement by UNCTAD on policy improvement in agriculture. In cooperation with FAO, IFAD and the World Bank, UNCTAD has produced a set of “Principles for Responsible Agricultural Investments that Respects Rights, Livelihoods and Resources” (Synoptic version 2010). This *WIR 2009* has had a continuing influence on international norm-setting.

*WIR 2009* is dedicated to John H. Dunning, a key figure in the founding of the UNCTC from his membership of the “Committee of Eminent Persons” throughout 20 years of the *WIR*.

*WIR 2010* is subtitled “Investing on a Low-Carbon Economy”. The key chapter here is IV –“Leveraging Foreign Direct Investment for a Low-Carbon Economy”. In fact, the chapter does more than this,
Stages or segments along a “typical” value chain

- Input supply
- Seed propagation
- Production (farming)
- Basic processing
- Trading and logistics
- Processing
- Retailing

The order (or even presence) of stages can vary by specific product or company supply chain (e.g., fresh fruit does not need to be processed; and can even be shipped to retailers); for instance, TNC supermarkets might cut out wholesalers from their supply chains and go direct to farmers.

Basic or initial processing of agricultural commodities can occur either close to production or further downstream. For example, cane sugar is refined close to or at cane plantations, while coffee in most instances undergoes only basic processing in developing countries and is roasted in developed countries.

The types of TNCs involved vary by Industry, e.g., food industries versus biofuels; or fresh fruit against processed foods within the food Industry.

Source: UNCTAD.
because it examines the global value chain. *(WIR* has to move in future from simply focusing on FDI to examining all aspects of TNC activity in the global economy, including non-equity forms.)*

Low-carbon foreign investment is defined (on p 103) as “the transfer of technologies, practices or products by TNCs to host countries – through equity (FDI) and non-equity forms of participation – such that their own and related operations, as well as use of their products and services, generate lower GHG (green house gas) emissions than would otherwise prevail in the industry under business-as-usual (BAU) circumstances”. This difficult and complex definition is necessary to capture the effects both up and down the value chain and in associated industries. It illustrates the persuasiveness of (potential) investment decisions and therefore the importance of the role of TNCs as investors, innovators, users, consumers and participants in low carbon investments. Again, TNCs (and FDI) are at the centre of a web of causality which the Report unravels.

TNC are correctly identified both as part of the problem and part of the solution to climate change. Both products and processes are important – FDI is identified in three low-carbon business areas (renewable, recycling and low-carbon technology manufacturing) at over $90 billion and non-equity forms (unmeasured) add greatly to this.

Factoring climate change into policies on TNCs and FDI is not easy. *(WIR 2010* proposes a “global partnership to synergize investment promotion and climate change mitigation and to galvanize low-carbon investment for sustainable growth and development” (p. XIV). It seems that we have come full circle in some aspects of policy – multilateral agreement is vital in this area, as it is truly a global problem.

*(WIR 2010* contained a number of innovatory features. A new chapter on national and international policy developments was introduced. New sections focusing on the least developed countries and vulnerable economies was introduced in the data section. Online facilities were used to present basic data in order to make the Report more user-friendly. The Report also emphasized UNCTAD’s seminal work in leveraging FDI and related technology flows to support the transition of developing countries to a low carbon economy.
Summary and conclusion

**WIR 2010**, for the first time, included an Epilogue: “Investment for Development: Challenges Ahead”. This set out an agenda which will shape future **WIRs**. Central to this is “the evolving nature of the TNC Universe”. This encompasses the rise of globally integrated networks focused on TNCs (or orchestrated by them), the widening use of non-equity modalities of conducting international business and a broader range of types of TNCs, including SWFs, state-owned TNCs, TNCs from emerging economies, private equity funds, family-owned groups and “umbrella groups”, all of which have been introduced in past **WIRs**. The focus in **WIR 2011** on non-equity modes of doing business is the first step of a wider exploration of the universe of TNCs, moving UNCTAD’s focus on from FDI to a deeper and wider-understanding and analysis of TNCs in development. This represents a further gear change in terms of UNCTAD’s ambitious research agenda.

This deeper penetration of TNCs activities could be extended by a focus on the funding and ownership, particularly the ultimate ownership of TNCs. The relationship between financing, the financial markets and TNCs is in need of urgent analysis following the financial crisis of recent years. This may lead to a closer focus on the institutional embeddedness of TNCs and their relationships with other elements of wider civil society.

As always, UNCTAD has to keep as it top priority development policy and impact. The relationship between poverty and TNCs, development policy and TNCs and the systemic challenge of investment and development achieve a new lease of life by attention of the UN Millennium Development Goals (MDG). The recent (and outstandingly successful) World Investment forum (WIF) 2010 in Xiamen China, proposed that the MDGs be built into the strategies of TNCs and fed through TNCs’ managerial incentive structures to achieve real results. UNCTAD and the **WIR** will undoubtedly revisit this issue.

The **World Investment Report** is known as the prime source of data on FDI. It is used extensively (and intensively) by academics, policy-makers, business people and students and received over 3 million downloads per year. Having read all 20 Reports I am impressed by the quality of analysis, range of coverage and depth of understanding of the **WIR**. Re-reading them after a number of years provides an excellent
revision of the development of theory and empirical knowledge on TNCs and FDI. The evolving theoretical structure (often implicit) of WIRs shows how international business theorists have sometimes struggled to keep up with developments in the organization and management of TNCs, sometimes have merely described current practice, and sometimes have led practice. The integrated systems of production in TNCs and globalization of the world economy have moved in parallel and WIRs have described and analysed this faithfully. Evolving management strategies such as offshoring, outsourcing, fine-slicing of activities, balancing global and local pressures, changes in motive for FDI, foreign market servicing strategies and the difficulties of implementing these strategies in TNCs are all present. The relationship of TNCs to development is a difficult effect to pick up with clarity. Different WIRs have placed different emphases on this relationship. In the best of them, development runs through the whole report like the lettering through a stick of rock. In others it is an add-on – sometimes an awkward one. This is partly dependent on the topic chosen but it remains difficult because the effects – linkages, spillovers and restructuring – are often indirect and problematic both conceptually and empirically. Philosophically, it is impossible to evade the inevitable alternative position – the counterfactual question: “what would have happened if the FDI had not taken place?”

Given these inevitable problems, the World Investment Report series over 20 years represents a considerable collective intellectual achievement of which UNCTAD can be justifiably proud.
Appendix I

Twenty years of the World Investment Report series

1991  The Triad in FDI
1992  TNCs as Engines of Growth
1993  TNCs and Integrated International Production
1994  TNCs, Employment and the Workplace
1995  TNCs and Competitiveness
1996  Investment, Trade and International Policy Arrangements
1997  TNCs, Market Structure and Competition
1998  Trends and Determinants
1999  FDI and Challenge of Development
2000  Cross Border M&As
2001  Promoting Linkages
2002  Transnational Corporations and Export Competitiveness
2003  FDI Policies for Development: National and International Perspectives
2004  The Shift Towards Services
2005  Transnational Corporations and the Internationalization of R&D
2006  FDI from Developing and Transition Economies: (Implications for Development)
2007  Transnational Corporations, Extractive Industries and Development
2008  Transnational Corporations and the Infrastructure Challenge
2009  Transnational Corporations, Agricultural Production and Development
2010  Investing in a Low-Carbon Economy

Forthcoming:-

2011
References


In order to better understand the role transnational corporations (TNCs) can and do play in the process of development, this article first examines how TNCs’ strategies and structures have evolved and how, in expanding their activities to new markets, they have engaged in a process of institutional co-evolution with other stakeholders. The article then turns to the role of Governments in facilitating development, particularly in relation to the emerging hybrid processes of public and private rule making involving TNCs that are central to the emerging investment-development paradigm.

The new paradigm addresses the question of how responsibilities should be defined in the context of the existing institutional structure comprised of local law and treaty obligations, complemented by various instruments of transnational private law. The process described here, and also reflected in the Ruggie framework and the Responsible Agricultural Investment (RAI) principles, might not satisfy those who would want to see binding norms on TNCs. However, it is suggested that past failures to develop such norms indicate that hybrid initiatives in which foreign investors and Governments engage in a process of negotiation to arrive at mutually acceptable standards might offer an alternative, pragmatic way forward. Such a process requires that TNCs, Governments and civil society act as credible partners in multilateral partnerships and that, at the supranational level, existing and future agreements such as IIAs be amended to better advance the development objectives of Governments.

1. TNCs and the development challenge

As a consequence of fundamental changes wrought to the world economy by progressive globalization and a new global political zeitgeist (already emergent, but crystallized in the wake of the financial and economic crisis) – a qualitative shift is occurring in the thinking about the role of TNCs in development. These changes have occurred in response to the opportunities and uncertainties presented by the processes of globalization, which have been accelerated by advances in communication and transportation technologies, and have enabled both new players and new markets to
emerge in the global economy. At the same time, these processes have led to a series of financial and economic crises in recent years and a consequent reassessment of the implicit social contract on which the balance between public and private governance is built, both nationally and internationally.

This reassessment is particularly opportune and runs deep, given the rising dissonance and disconnect between public and corporate statements on globally critical policy challenges, such as the financial crisis, climate change or food security – and the true urgency of the actions required at the institutional, technological and economic levels. These challenges have underscored the necessity for institutional reform, which has resulted in increased government involvement in markets both directly through state ownership, and indirectly through new regulation since 2008 (UNCTAD, 2010). The period of crisis also coincides with the institutionalization of the G-20 and G-77 groups of countries as important actors in the global arena. Against this backdrop, a rethinking is underway, both regarding new approaches to development and – particularly pertinent for this article – the role of TNCs in development.

In order to better understand the role TNCs can and do play in development, the article begins by examining how TNCs have evolved in terms of their strategies and structures, and how, in expanding their activities to new markets, they have engaged in a process of institutional co-evolution with other stakeholders. The analysis then turns to looking at the role of Governments in facilitating development, particularly in relation to their market enabling policies, and the hybrid processes of public and private rule making that are central to the emerging investment-development paradigm. The aim of the new paradigm is to respond to the pressing challenges of development by promoting a pragmatic process of engagement, whereby Governments, TNCs and civil society can achieve a better balance between rights and responsibilities on all sides. While the new paradigm is still unfolding, and the article refrains from heralding its arrival, some existing initiatives are examined, particularly in the area of responsible agricultural investment and human rights protection that reflect the spirit of the new paradigm.
2. TNC evolution: form and structure

The opportunities and challenges faced by TNCs in the contemporary global economy have resulted in changes to their strategies and structure, and contributed to the emergence of new types of TNCs that are shaping the nature and characteristics of both mature and emerging markets and industries. Such changes are visible both in the composition of foreign direct investment (FDI) as well as in the increasing importance of non-FDI modes of cross-border activity. Over the past decade, various issues of the World Investment Report have highlighted substantial changes in the composition of FDI, for example in the rise of M&As as a tool for cross-border entry by TNCs, the increasing share of services in FDI flows, and the return of extractive industries, infrastructure and agriculture as mainstays of TNC activity, especially in developing countries (UNCTAD, 2000; 2004; 2007a; 2008; 2009). Cutting across all of these issues is the growing share of developing countries in both inward and outward FDI. As TNCs have widened and deepened their international expansion into new markets, a number of key features related to their form and structure have gained particular salience.

The rise of integrated international networks

An important effect of globalization on TNCs, under the onslaught of dynamic competition with their peers, has been a fine-grained splitting of value chain activities and their dispersal across borders. Initially, this dispersal of activities across borders was typically coordinated under the auspices of one firm and focused primarily on production and operations (including by services companies). It was hence referred to as integrated international production (UNCTAD, 1993). Increasingly, however, similar coordination is being achieved between independent or, rather, loosely dependent entities, which can perhaps be referred to as integrated international networks. Moreover, this international dispersal of activities in the value chain is increasingly stretching across the whole gamut of TNC functions, including activities that have traditionally been anchored to the home base, such as R&D and design (UNCTAD, 2005). These globally dispersed networks have profound implications for home and host country policymaking in many areas, from employment to the Governments’ ability to conduct independent
economic and industrial policies in an interdependent world. In many ways, these are old issues, but writ large and qualitatively different.

**Widening use of non-equity forms**

Parallel to the process of more fine-grained division of the value chain, the expansion of various non-equity forms of TNC activity has also become a significant feature of the emerging global division of labour. These non-equity forms include, for example, various types of international supplier and distribution relationships, such as international subcontracting in manufacturing industries such as automobiles, electronics and garments (Giroud and Mirza, 2006), as well as contract farming in agriculture and food processing (UNCTAD, 2009). They also involve outsourcing of services such as IT support (UNCTAD, 2004), international franchising and development alliances (e.g. in fast food retail stores), variations of build-own-operate-transfer arrangements and other concessions (e.g. in infrastructure projects) (UNCTAD, 2008) and management contracts (e.g. in international hotel chains) (UNCTAD, 2007b). For much of the post-Second World War era, FDI was (or was deemed to be) the primary modality used by TNCs in their international operations. However, various non-equity forms have enjoyed a wide use in the past (Jones, 2010; Wilkins, 1970; Wilkins and Schröter, 1998), and the increasing variety of contractual forms in the contemporary global economy calls for

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1. See also Sturgeon, van Biesenbroeck and Gereffi (2008) on the automotive industry.
2. For example, according to the *World Investment Report* (UNCTAD, 2009), in 2008 the food processor Nestlé (Switzerland) had more than 600,000 contract farmers in over 80 developing and transition economies as direct suppliers of various agricultural commodities. Similarly, Olam (Singapore), a developing-country TNC, has a globally spread contract farming network: in 2008, it sourced 17 agricultural commodities from approximately 200,000 suppliers in 60 countries (most of them developing countries).
3. In the call centre industry, the largest contract service providers include companies such as Convergys, ICT Group, Sitel and Sykes; in IT related services, there are also a growing number of external service providers including companies such as IBM Global Services, EDS, Accenture and Hewlett-Packard (UNCTAD, 2004).
4. McDonalds is among the best known international franchiser; according to its annual report, of the 32,478 restaurants it franchises and operates in 117 countries, 26,216 (roughly three-quarters) are franchised.
5. Between 1998 and 2006, 62% of all new projects in infrastructure in developing countries were concessions of various forms (UNCTAD, 2008).
more research to understand their significance and implications for development.

*A broader range of types of TNCs*

With their exponential expansion worldwide has come the rise (or re-emergence) of different types and forms of TNCs (appendix 1), some with quite novel strategies and business models and implications for development. For instance, the increased use of contractual partnerships by TNCs (which is connected to integrated networks, as mentioned above) may foster greater levels of codification and diffusion of knowledge that yields externalities to other (local) firms (Dunning and Lundan, 2010). Second, by adopting more distributed and open innovation structures, TNCs are both benefiting from and helping to build indigenous clusters of innovative activities in emerging markets. Third, the increasing involvement of States as owners of large TNCs is raising potentially important questions about investment objectives that go beyond simple shareholder return.

All of these elements have been particularly prominent in recent years in sectors such as infrastructure and agriculture, where contractual forms of TNC activity have contributed to economic upgrading and institution building in the host countries (UNCTAD, 2007a, 2008, 2009). Indeed, the need for a better understanding of the extent, variety and consequences of contractual forms of TNC activity, is a key emerging area for policy-orientated research. Furthermore, the rise of TNCs from the South has also brought to the fore two emerging issues. First, that created asset-seeking strategies are becoming more prevalent, as firms from developing countries purchase assets in Europe, the United States and other developed countries to acquire technology and know-how, as well as access to distribution and brand names. Second, the rise of South-South FDI is increasing opportunities for investment to developing host countries, leading to the introduction of new skills and business models as well as boosting competition with developed country TNCs in areas where the established investors previously possessed greater market power (UNCTAD, 2006).

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6 See the article by Zhan in this issue.
3. TNC evolution: institutional context

TNCs and institutional co-evolution

Due to the complexity of the changes confronting Governments, firms and civil society alike, the importance of appropriate institutions has become paramount in achieving sustainable development. Such institutions consist both of formal rules (e.g. constitutions, laws and regulations) and informal practices (norms of behaviour, conventions and self-imposed codes of conduct). Institutions (and their enforcement mechanisms) set the “rules of the game”, which firms and other organizations need to follow to maintain or gain legitimacy (North, 1990, 2005). Following this definition, governments are the primary source of formal institutions in the form of laws, regulations and their enforcement mechanisms. This includes the rules that underpin markets, such as the enforcement of property rights and contract law. However, the market economy also generates its own contingent of rules, including private law relating to the enforcement of contracts, codes of conduct as well as systems of technical standards (Backer, 2007; Calliess and Zumbansen, 2010).

In terms of the formal institutions that support market exchange, such as property rights protection, reliable contract enforcement, and a predictable and transparent regulatory structure, there is considerable evidence that good governance is conducive to investment and growth (Rodrik, Subramanian and Trebbi, 2002). Similarly, an environment of good public governance with low levels of corruption and a high degree of policy consistency are generally necessary to achieve economic development (Keefer, 2004). Indeed, most scholars attribute a causal relationship between good governance and higher economic growth, although one must also acknowledge that there are likely to be feedback loops with economic growth providing the resources necessary to improve the institutional infrastructure (Glaeser et al., 2004).7

7 In terms of informal institutions, while increasing attention is being paid in development policy to the institutions that encourage civic participation and cooperation, these have not been connected to the context of investment and economic development. However, this is an important dimension to consider, since the policies that ensure social inclusion and afford the possibility for all members of society to benefit from economic growth while protecting them against extreme adversity are foundational to other policies that encourage entrepreneurship and local business development.
This implies that in addition to harnessing TNCs in terms of their financial and technological contribution to development, more attention could be paid to the social contribution and institutional co-evolution that may accompany TNC investment (see appendix 2). While the responsibility for the macro institutional climate and good governance rests firmly on national Governments, at the micro level, tripartite coalitions between Governments, civil society and firms, including TNCs, are increasingly important in shaping institutions, and thereby creating the conditions that are conducive to economic activity (Dilling, Herberg and Winter, 2008). This is the case, for instance, when TNCs, sometimes together with local civil society partners, encourage local entrepreneurship by providing education, training and supplier linkages that enable local firms to expand the scale and scope of their operations as well as to upgrade their human resources.

From an economic and development point of view, the primary challenge is to lower the costs of transaction in the market, which depends heavily on the ability of the market actors to establish trust and cooperation. For the purpose of value creation, TNCs have an incentive to try to structure transactions in a way that encourages the building of cooperative relationships and the upgrading of institutions. However, this cannot happen in isolation without the involvement of Government and civil society in providing essential public goods. Policies that foster education and social cohesion are a necessary precondition for more targeted policies that promote local entrepreneurship and linkage formation. Thus, local absorptive capacity is not simply a question of achieving the minimum level of technological capabilities to participate in global supply networks, but also the social capital that allows contracts to be executed at a reasonably low cost. Given the prevalence of contractual relationships in TNC value chains, these transaction costs can have a significant impact on economic activity and ultimately on development.

In this context, one potential benefit of TNC activity lies in the development of routines for organizing transactions that, over time, become sufficiently clear and codified so that they too can become diffused into the marketplace, thereby influencing the prevailing standards of how transactions are conducted (Dunning and Lundan, 2010). As a result of both the deliberate transfer of technology and governance institutions, as well as through any possible externalities
that accrue to local firms, TNC participation can help overcome some of the difficulties of expanding the scope of economic activity in countries where social cohesion is low and where the level of education may not be sufficient.

At the same time, it should also be recognized that TNCs may exacerbate existing institutional deficits by acceding to the payment of bribes, by condoning or supporting the activities of private (rogue) militias to maintain security, or by using their political influence to shut out potential competitors. Not much is known about the details of such processes at present, and consequently the developmental impact of institutional co-evolution is an important area of new research.

**TNC self-regulation and multi-stakeholder initiatives**

Over time, TNCs are likely to influence both the formal and informal institutions in the host country. One of the channels of influence has been the participation of TNCs in national and international standard setting as well as their participation in industry and firm level self-regulation. Their influence has also been quite visible in privatized industries, where TNCs have taken over the delivery of public services, such as health, education or infrastructure services, in different types of public-private partnerships.

Such developments have been prompted by the increasing recognition that both TNCs and Governments have good reasons to adopt a less adversarial stance. This is because, among other reasons, the quality of regulatory institutions directly affects TNCs’ compliance cost, and a credible governance environment in the home and host countries is a precondition for investment that employs advanced technologies and managerial processes, including those intended to improve the social performance of TNCs. There is thus some scope for the public and private sectors to combine forces in the national or international regulatory sphere, including in the provision of public services.

Complementary to the greater cooperation between TNCs and Governments in the regulatory and standard-setting realm are the activities that fall under the banner of corporate social responsibility (CSR), which includes elements such as the adoption of ISO 9000/14000/26000 standards in TNC supply chains, a variety of labelling
initiatives, the establishment of codes of conduct, and the publication of social performance reports (van Tulder and Kolk, 2001). Some of the best-known cases of firm specific initiatives involve TNCs that initially became targets of NGOs and suffered a loss of reputation due to the exposure of their labour, environmental or human rights practices (Frynas, 2005). Another type of self-regulation involves collaboration between firms in an industry sector to arrive at common rules, often to forestall the need for public regulation or to influence its content. Finally, firms also engage in bilateral and multi-stakeholder initiatives. Indeed, like TNCs, many modern NGOs are global in reach, and different kinds of partnerships with NGOs can form an integral part of the value-creating process of TNCs (Teegen, Doh and Vachani, 2004).

However, on account of the broad range of TNC stakeholders, the range of topics falling under the CSR rubric is also very wide. At its core are issues such as environmental performance and labour standards, and in recent years more attention has also been placed on poverty alleviation and human rights issues in developing countries. Issues that have only sporadically entered the mainstream of CSR include labour organization and collective representation, while those related to tax minimization and transfer pricing have seldom been discussed in connection with TNC social responsibility, despite their considerable impact on host countries.

Critics have accused the voluntary CSR agenda for being centred on areas of interest to developed countries, rather than those of immediate concern to people living in developing countries (Lund-Thomsen, 2008). Even so, self-regulation at the firm level is becoming quite common among large TNCs, and an increasing number of them are also beginning to report on their activities in separate social or corporate responsibility reports. However, since the various non-financial factors constituting CSR are very difficult to measure, social responsibility reporting today provides a selective and incommensurate range of measures. While some countries provide regulatory guidelines on social reporting, firms are often free to choose what to report and in what form.

A separate area of potential TNC involvement in the public sphere involves various types of agreements under the overall rubric of public-private partnerships. In addition to providing public services
at higher quality or lower cost than might be possible under other arrangements\(^8\), an important aspect of public-private partnerships is that they may support new market creation. by, for instance, creating an infrastructure in which renewable power can be harnessed (thus enabling the provision of a public good), or by helping foster institution building (thereby, perhaps, supporting better regulatory oversight).

4. The emerging investment-development paradigm

Alongside the evolution of TNC activities, which has resulted in a greater variety of cross-border value-adding networks comprised of both hierarchical and contractual relationships, there have also been appreciable changes in terms of the role of the State in the economic sphere. In particular, the past decade has seen the resurgence of the State in connection with issues of global importance, such as the economic and financial crisis, climate change and sustainable development (UNCTAD, 2010), the historical consequences of previous ebbs and flows of state influence notwithstanding.\(^9\)

One of the essential implications of the changing nature and roles of both firms and Governments is that the wider policy space creates an unprecedented demand for new governance institutions, to which Governments, firms and civil society can all contribute at

\(^8\) However, this is contested, for instance, with respect to water services as discussed in UNCTAD (2008).

\(^9\) The market-led ideologies and policies that gained popularity in the 1980s gradually altered the contours of the modern welfare state in profound ways. The different responsibilities assumed by Governments can be divided into three types (Hurrelmann et al., 2007):

- Outcome responsibility if the state is the ultimate guarantor over the provision of normative goods (security, legal certainty, democratic self-determination, economic growth and social welfare);
- Regulatory responsibly if the state decides the processes through which normative goods are to be provided;
- Operational responsibility if state institutions actually perform the necessary tasks.

In the 1960s and 1970s, Western Governments assumed full responsibility for the provision of all normative goods, but this is much less likely to be the case in the contemporary global economy. In general, the monopoly of the state in the provision of normative goods has changed in two main ways – through privatization and internationalization (Zürn and Leibfried, 2005).
different levels. The emerging paradigm suggests that there needs to be a reconfiguration involving Governments, civil society and firms, whereby hard instruments are not simply used to protect the interests of investors, but are also engaged to advance urgent development goals such as alleviating poverty or hunger.

Importantly, after many unhappy experiences with both irresponsible State and TNC activities in the past, the paradigm of market-harnessing development suggests that public-private cooperation could produce significant business opportunities in developing countries, provided that new national and international guidelines, rules, regulations and agreements were premised on more responsible behaviour by both TNCs and Governments. Specifically, what role might TNCs play in this process, at both the national and international levels?

Due to their experience of different operating environments and different types of contractual partnerships, TNCs have developed and employ a wide variety of governance forms to meet their commercial objectives. These include various ways of structuring contracts in order, for instance, to balance risks and responsibilities, improve quality and reliability, and to resolve conflicts. At the national level, Governments can use this governance capability as an important component in their pursuit of market-harnessing development. At the same time, firms are likely to require the guidance of Governments in defining the goals of development, while the latter also need to provide a stable and credible policy environment to enable long-term investment.

This could mean, for instance, that having set its policy objectives, Governments might oblige firms above a certain economic size, including TNCs, to undertake a process of due diligence concerning the social and political risks they encounter in their operating environment. Such a process has been advocated under the Protect-Respect-Remedy framework concerning the human rights obligations of TNCs\(^\text{10}\), and

\(^{10}\) The Ruggie framework places a great deal of emphasis on the responsibility of states to effectively protect human rights within their own jurisdiction, while also obliging multinational enterprises to respect the efforts of national Governments to achieve these goals, and where rights violations have occurred, to provide timely and adequate access to judicial and non-judicial remedies to those affected. It also specifically urges firms to apply processes of due diligence with respect to their human rights obligations (Ruggie, 2010).
it has also been proposed as part of the Principles for Responsible Agricultural Investment (RAI) established by UNCTAD, FAO, IFAD and the World Bank. The TNC would put forward a plan that addresses, at the very minimum, how it intends to do no harm, i.e. not to further exacerbate existing vulnerabilities, but may also propose a positive plan on how its activities might contribute to meeting the social objectives of the Government in the long run.

Depending on the kinds of obligations placed upon TNCs, the manner in which Governments would address the issue of noncompliance needs to be considered. The State has the choice of both judicial and non-judicial mechanisms of enforcement, but in a partnership-based model, a natural choice would be to adopt some of the best practices of alliance management as practised by the firms themselves. This includes, for instance, the definition of some stop-gates where performance is assessed, as well as the identification of corrective mechanisms that can be employed to align interests in order to achieve desired targets (de Man, 2004).

Such a market harnessing framework is based neither on command-and-control regulation nor solely on voluntary bottom-up activity, but could be a combination of the enhanced ability and duty of States to set their development objectives in operational policy terms, and the responsibility of firms to develop the means whereby these can be addressed, including processes of effective monitoring. Such a hybrid process combining elements of public and private governance has many advantages over a system that would place the burden of development solely on Governments. It would also be beneficial for TNCs and other firms, since it would create a more transparent framework within which the parameters of responsible corporate

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11 The seven RAI principles are: existing rights to land and associated natural resources are recognized and respected; investments do not jeopardize food security but rather strengthen it; processes relating to investment in agriculture are transparent, monitored, and ensure accountability by all stakeholders, within a proper business, legal, and regulatory environment; all those materially affected are consulted, and agreements from consultations are recorded and enforced; investors ensure that projects respect the rule of law, reflect industry best practice, are viable economically, and result in durable shared value; investments generate desirable social and distributional impacts and do not increase vulnerability; and environmental impacts of a project are quantified and measures taken to encourage sustainable resource use, while minimizing the risk/magnitude of negative impacts and mitigating them.
citizenship can be set. This process would not, of course, exclude the possibility of firms engaging in voluntary CSR activities beyond those required to meet policy objectives; but it would ensure that responsible citizenship in the host country was primarily addressed to the needs of the host country.

The principle of responsible corporate citizenship for development should not be seen as an add-on to the ordinary activities of the TNC, as it describes the conditions under which all firms in a given market should operate to advance the goals of sustainable development. The parameters of responsible citizenship could be set by Governments in consultation with civil society and firms, but in the last instance, they need to be put in operational policy terms by Governments. National treatment is one of the cornerstones of the liberal trading system, but a guarantee of national treatment should be accompanied by a requirement for responsible corporate citizenship. Almost invariably, participation in an open global economy involves some “nationhood costs” of integration (Gray and Lundan, 1994) in order to ensure that domestic firms are treated no more favourably than foreign investors (or vice versa). Such concessions are necessary, but they should be matched with the ability of Governments to set effective rules to govern the behaviour of both domestic and foreign firms in order to achieve its social and developmental aims.

Developing new governance institutions that effectively balance the interests of society with those of business/TNCs is not an easy task, especially in the context of market-harnessing development, but the multi-stakeholder model carries a promise that when new governance forms are developed that effectively address this balance, these are articulated and made explicit in the process of negotiation. Thus following the same logic as the distributed knowledge creation model increasingly adopted by TNCs, innovative solutions to meet policy goals could also be developed in a distributed manner. This process can result in not just improved local solutions, but also in the emergence of some best practices that have more general applicability across borders.

The new paradigm addresses the question of how responsibilities should be defined in the context of the existing institutional structure comprised of local law and treaty obligations, complemented by various instruments of transnational private law, which serve to fill in some of
the institutional voids (Calliess and Zumbansen, 2010; Lundan, 2011). The process described here, and also reflected in the Ruggie framework and the RAI principles, is not likely to satisfy those who would want to see binding norms on TNCs. However, past failures to develop such norms and to reach a multilateral agreement on investment with binding force suggests that an embrace of hybrid initiatives that engage foreign investors and Governments in a process of negotiation to arrive at mutually acceptable standards might offer a way forward. Such a process requires that TNCs, Governments and civil society are able to act as credible partners in multilateral partnerships and that, at the supranational level, existing and future agreements such as IIAs can be amended if necessary to “do no harm”, ensuring that actions by Governments to pursue legitimate policy goals could not be interpreted as expropriation.

References


Appendix 1. A bestiary of TNCS

TNCs are heterogeneous in nature, with a wide variety of structural forms, origins and ownership. The different types mentioned below are not mutually exclusive, but the description indicates some of the salient issues that might need to be considered in analysing them – particularly in terms of policy.

I. Key structural forms adopted by large TNCs

a) Multidivisional

The multidivisional form allows for some specialization of responsibilities by giving divisional managers responsibility for a product group or a geographical area, and it also formalizes a vertical system of intra-firm communication and decision making. The task of divisional managers is to concentrate on the maximum exploitation of local knowledge, which leaves more room for corporate management to plan and execute long-term strategies. While the multidivisional form originates in the 1920s, variations of it are in wide use today.

b) Matrix

In an attempt to match local responsiveness with global integration, in the 1980s some TNCs began to adopt an organizational structure known as the matrix structure. In a matrix organization one organizational form (e.g. based on products) is superimposed on another (e.g. based on geography). Instead of a hierarchy wherein a product manager has control over various regional managers, both kinds of managers have equal status, and their responsibilities overlap. In TNCs adopting matrix structures, lines of communication flow laterally across main dimensions; both product- and regional-specific expectations are utilized in solving problems and in responding to opportunities.

c) Network

A general term used to describe a variety of large TNCs, which have increased their use of external contractual relationships while at the same time, delegating more responsibility to the subsidiary level (Birkinshaw and Hagstrom, 2000; Frost, Birkinshaw and Ensign, 2002).
Structurally, the network TNC is characterized by an internal network of subsidiaries and an external network of contractual partners. In addition to cross-border outsourcing, such contractual relationships can involve R&D activities and marketing alliances, as well as original equipment manufacturing contracts.

d) Metanational

An emerging form of a network TNC where the essential capabilities of the firm reside in its ability to utilize and leverage knowledge globally. The metanational firm is a distributed organization with sophisticated methods of identifying and exploiting new knowledge, but also potential problems of coordination and control (Doz, Santos, and Williamson, 2001; Verbeke and Kenworthy, 2008.

e) Front-end/back-end

A fairly recent solution to the integration-responsiveness problem, which consists of a front-end or customer facing part of the organization, and a back-end or production related part (Westney and Zaheer, 2001). The front end is designed to meet and anticipate the needs of global customers, and to provide holistic solutions to their problems, including products or services that might not currently be on offer. The back end is designed to adjust flexibly to the changing demands flowing from the front end by using outsourcing and OEM production.

II. TNCs defined by ownership

(For structures of publicly-listed TNCs see I; family-owned TNCs are covered in III.)

a) State-Owned Enterprises (SOEs)

In addition to some large privately held firms, SOE TNCs are among the largest non-listed companies in the world. The internationalization of SOE TNCs, especially from developing and transition economies (but not exclusively so) is growing, with – in some cases - national security considerations in host countries.
b) Sovereign Wealth Funds (SWFs)

Also state-owned, SWFs have started to diversify their asset portfolios through FDI over the past decade (in some cases longer). To the extent that SWFs gain controlling stakes in host country firms (perhaps through M&As) they can at times behave like SOE TNCs. In both cases, however, state ownership per se may not have any essential impact on firm strategy. However, more attention is being paid to both types of investors due to their increasing economic significance, and the potential for their investment decisions to be guided by something other than a purely market-oriented logic.

c) Private equity funds

Private equity funds invest in venture capital, distressed assets, and takeovers/buyouts of firms with the aim of refinancing and restructuring these assets, a proportion of which is FDI (when it is long-term, with a controlling stake). These collective investment funds are more opaque than most listed firms, which has led to some concerns about their perceived orientation towards short term gains. Cross border M&As by private equity firms contracted sharply in the wake of the financial crisis.

III. Family-owned TNCs

a) Family-owned business groups in emerging markets

Many business groups in emerging countries are family owned and, frequently, conglomerates. There is a large literature on what advantages (and costs) these structures entail in terms of access to resources and markets, the implications for internationalization, and the impact on host countries (Khanna and Yafeh, 2007). As with similar groups in developed countries in the past, they may evolve into other forms, typically publicly-listed companies.

b) Groups centred on industrial districts

These are groups of family firms that engage in flexible specialization in established industrial districts in e.g. Italy, Germany and Spain. While many of the constituent firms in such groups may be
small and purely domestic in scope, their products are marketed by large TNCs with global brand names.

c) Large family-owned TNCs

TNCs in this group are prominent in several European countries, where debt rather than equity financing has been prominent. These include large industrial firms whose structures are similar to other firms in part I, but whose closely held ownership may e.g. favour more long-term strategies in terms of labour relations and a stronger commitment to the home base.

IV. New types of small TNCs

a) Entrepreneur investors

Small firms that are set up by entrepreneurs from abroad, sometimes linked to a country’s diaspora, who bring the human skills and capital necessary for entrepreneurial activity. They are commonly regarded as “free-standing companies”, rather than TNCs, because they do not possess a parent company.

b) ”Born global” firms

Small TNCs that are/become international very shortly after their inception. Such firms are emblematic of the opportunities created by modern communication methods that allow smaller firms access to the global marketplace; in most cases the firm is involved in niche products/services (hence the need to expand to foreign markets).
Appendix 2. TNCs and institutional co-evolution

Following Cantwell, Dunning and Lundan (2010), three basic types of engagement between TNCs and institutions can be identified. The first is institutional avoidance, in which TNCs take the external institutional environment as a given, but in which they are able to make choices between different institutional environments. Faced with a weak institutional environment, characterized by a lack of accountability and political instability, poor regulation and deficient enforcement of the rule of law, the response of most TNCs is likely to be characterized by an ‘exit’ rather than a ‘voice’ strategy (Hirschman, 1970). Exceptions to this include natural resource seeking investment and some forms of infrastructure investment, where the number of alternative investment locations might be limited. The prevalence of this type of behaviour is evident in the results of many studies confirming that the more footloose forms of TNC activity are mostly concentrated in countries characterized by good governance (Dunning and Lundan, 2008; Kaufmann, Kraay, and Mastruzzi, 2007).

The second form of engagement is institutional adaptation. As in the previous case, the TNC treats the institutional environment as exogenous, but in this case it seeks to adjust its own structure and policies to better fit the environment. The means to achieve this objective include the use of political influence and, in some cases, bribery, but it may also involve efforts by the TNC to intentionally emulate the behaviour, commercial culture and institutional artifacts that are most desirable in the host country context. At the extreme, the TNC may wish to ‘go native’, and to become an insider in the host country market, possibly even hiding the aspects that make it appear foreign.

In contrast to the first two cases, in the third one, the institutional environment is assumed to be partly endogenous, and the TNC is engaged in a process of co-evolution. In institutional co-evolution, while firms may employ some of the same tactics they used under the previous scenario, their objective is no longer simply to adjust, but to affect change in the local institutions – be they formal or informal. For
example, a TNC might engage in political activities to advance specific kinds of regulation or market structure that give it an advantage over its competitors. In doing so, the TNC might also align itself with domestic firms in lobbying the government for economic protection or support.
Towards a forward-looking and policy-orientated research agenda

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As the global economy recovers from a series of crises, the role of foreign direct investment (FDI) in creating sustainable and inclusive growth is more important than ever. This is even more so in light of the contribution FDI can have in addressing global challenges, such as combating climate change and pursuing the Millennium Development Goals (MDGs). However, today, investment stakeholders and policy makers worldwide lack a clear vision and coherent policy framework for promoting responsible investment. This is aggravated by a lack of understanding about, and reliable data on, the sustainable development contributions of FDI. This essay highlights a series of issues for further research with a view to fostering the theoretical, analytical and empirical bases needed for developing a coherent policy framework that effectively promotes responsible investment.

1. The new paradigm – “investment for development”

Devising a novel investment policy research agenda bodes well with the emergence of a new “investment for development” paradigm.¹ This new paradigm is based on emerging approaches to development that stress a strengthened role for the state in developing countries, including with respect to countries’ dealings with TNCs (figure 1). These new development approaches differ from previous ones, both in terms of the goals as well as in their means to reach these goals. Most importantly, they adopt a market-harnessing as opposed to the previous market-led approach.² Accordingly, these new development approaches are based on the renaissance of the State, which reflects a rebalancing of the public and private spheres – a

¹ See Lundan and Mirza (2010), elsewhere in this issue, for more details of the emerging paradigm.
² The market harnessing approach is characterized by, (i) more attention being accorded to full ownership of developmental strategies by each country, both governments and citizens; (ii) attention to the importance of indigenous resources and capabilities and the processes required to upgrade these; and, (iii) a focus on the critical role of institutions in facilitating both economic transactions and social improvement.
rebalancing that applies to development, as much as to other spheres of political-economic interaction (WIR 2010, chapter III).

Within this putative emerging investment-development paradigm, governments have a renewed opportunity to formulate and implement policies that advance the goals of development. This requires that governments create the regulatory and institutional frameworks that ensure development enhancing contributions by TNCs through responsible investments (e.g. generating employment, technology transfer, and by contributing to the tax base in the host countries).\(^3\) This process cannot be led by governments alone. Instead it requires the collaborative interaction between policy makers, private sector/TNCs and other investment stakeholders, including civil society and academia.

**Figure 1. The evolution of state-TNC interaction: from market-regulated growth to market-harnessing development**

Against this backdrop, this article highlights a number of critical issues in relation to investment for development. It pays heed to new and old challenges, and – regarding the latter – asks how they need to be recast in the new era. Important clusters of salient issues

\(^3\) For further discussion of this point, see Lundan and Mirza (2010) op cit.
include (i) understanding and measuring the sustainable development contribution of FDI; (ii) devising policies that effectively promote responsible investment and managing their interaction with other public policies; and (iii) devising an international governance framework for responsible investment.

2. Understanding and measuring the sustainable development contribution of FDI

The role of FDI in development remains controversial. Open questions linger both concerning the impact of inward FDI on host country development, and the impact of outward FDI on home country development. More questions arise when aiming to concretize the sustainability dimension of FDI. Research methodologies to undertake impact assessments are largely absent or contested, and the required data are not readily available. Yet data, as well as a coherent theory, are the fundamental bases required for informed and effective policy making.

- While FDI statistics have improved over the years, allowing policy analysis to draw upon comprehensive time-series and cross-country comparable data, quantifying the widening TNC-host country interface remains a challenge.

There are numerous methodological difficulties to evaluating the TNC-host country relationship. For example, when aiming to collect data in line with the evolving use of non-equity forms by TNCs (*WIR 2011*), the increasing importance of low-carbon investments, which in itself is a fluid concept (*WIR 2010*) or other “novel” phenomena (e.g. those requiring a gender differentiated and inter-generational approach). Some TNC impacts on development might not be quantifiable – or at best are difficult to quantify over time. All of this creates novel conceptual challenges that need to be solved before one can embark on the expansion of data collection. Moreover, lack of comparable data also abounds regarding the “traditional” areas of impact (e.g. employment generation, technology generation and dissemination, competitive and demonstration effects). Finally, adequate attention must be paid to improving the statistical capabilities of developing countries.
• TNCs and the TNC universe have evolved over time. Also the patterns, pathways and scale of TNCs’ impacts on development have changed. Together with changing priorities for policy makers, this calls for innovations in the theory of TNCs and FDI.

The new internationally integrated [production] network – including the increasing importance of non-equity investments and the breaking up of global value chains – requires novel theoretical underpinnings. Similarly, some of the effects that TNCs have on host countries (e.g. the crowding-out of domestic actors or the absorptive capacities needed by domestic companies) have not been adequately understood and thus necessitate new theoretical frameworks to properly analyse them. Ownership and control threshold conditions for TNC establishment, as well as the interplay between TNCs and institutions all call for novel theories, which should also be able to provide insight on current trends, such as regional integration and the emergence of TNCs from the South.

• Regional integration has been on the rise, both with respect to trade and investment integration, as well as in the South-South and North-South contexts. However, these integration processes, as well as their impacts on investment and development have not yet been fully understood. There are many open questions regarding the impact of trade liberalization on investment flows; the investment creation and investment diversion effects of regional integration within and outside regions; as well as attendant broader development implications. In light of the ever increasing network of regional integration initiatives that cover investment issues, a clearer understanding about the implications of such initiatives is needed.

• The last decade has seen an emergence of TNCs from the South. This has triggered a paradoxical perception of the internationalization of such TNCs and in particular State-owned TNCs. While their ascendancy at the international scene is viewed with suspicion by developed countries, their role in the South-South context is viewed positively. Their dynamism creates both opportunities and questions in terms of how to best harness Southern TNCs for generating development benefits. To address these questions, the development path of Southern TNCs (e.g. their comparatively later emergence on the international scene, their specific drivers and determinants as
well as their different production practice and governance forms) has to be more fully analysed. Further, the rise of Southern TNCs also poses policy challenges to their home country governments in terms of rebalancing their international position on inward and outward FDI.

- Most importantly, novel theories are needed to understand and measure the environmental and social implications of TNC activities. With regard to the latter, investment can, for example, help create employment opportunities for the poor and marginalized, or help improve their access to basic goods and services. A crucial condition for that to happen is the development of viable business solutions. Ensuring that investor conduct in this regard is not a complementary pro-bono or philanthropic activity, but instead, forms part and parcel of a sustainable and beneficial company strategy. However, how to more effectively target investment towards the poor and marginalized who find themselves at the bottom of the pyramid is far from clear.

More comprehensive data and a better understanding of the above phenomena would allow policy makers to embark on devising policy options that effectively promote responsible investment.

3. Increasing interaction between investment and other public policies

Recent years have seen a stronger interaction between different areas of policy making. This reflects today’s economic reality, where FDI is not occurring in isolation, but instead impacts on countries’ economic, environmental and social conditions. This interaction stems from interfaces between, among others, investment and environmental or social (e.g. climate change, pursuance of the MDGs) policies; between investment, competition and trade policies; or between investment policies and policies aimed at strengthening linkages and spillovers from foreign investors (e.g. policies aiming at diffusing technologies). While some of these interfaces have been recognized for several years (e.g. those with industrial or competition policy) others are novel (e.g. those with sustainability or corporate governance initiatives). Moreover, questions have been posed about the effectiveness of traditional fields of investment policies (e.g. investment incentives), as well as the need
to cast the concept of investment policies wider, to adequately deal with non-FDI related sources of financing.

In sum, investment policy itself and its interfaces with other policies need to be better understood. This needs to be done to give policy makers the ability to manage interactions in a manner that ensures coherence and maximises synergies, and adapt to the regulatory and institutional contexts of countries at different levels of development. In particular:

- **Competition for investment** remains a critical issue, and no international consensus has emerged on how to deal with it. This competition involves both a potential race to the bottom in terms of regulation, and a potential race to the top in terms of the granting of investment incentives. The risks arising from it include welfare loss, market distortion, reverse discrimination of domestic investment and regulatory arbitrage. In addition, there are free rider problems, which exacerbate in the absence of collective action. All of these merit attention, especially from the perspective of its implications for the poorest countries that are striving to implement policies that effectively attract much-needed FDI.

- FDI is not the only means of financing development. Instead, there many other, including novel forms of investment flows for development financing, such as ODA, public private partnerships, bank lending, portfolio investment or reinvested earnings. Moreover, TNC activities are evolving, going beyond FDI to new kinds such as non-equity modalities. All of these need to be better understood and managed in a manner that allows enhancing synergies with FDI, with a view towards maximizing their development contribution.

- Another policy challenge relates to the impact which TNCs may have on the market structure and competition in host countries. Foreign TNCs may crowd out domestic companies, endanger indigenous production capacities, or create the potential for monopolistic or anti-competitive practices and attendant abuses of their dominant positions. In do doing, TNCs may raise challenges, for example, for the provision of essential goods and services for the poor and marginalized. Creating effective competition laws and policy frameworks that properly address these issues while fitting with host country governments’ regulatory and institutional capacities...
remains a fundamental policy challenge. Open questions also exist regarding the role of international cooperation approaches in the field of competition law and policy.

- Also the **re-emergence of industrial policy** poses novel questions. On the one hand, policymakers need to learn from past experiences (e.g., earlier forms of infant industry policy; strategic trade and industrial policy). At the same time, they need to adapt to today’s challenges, including the need for industrial policies to promote sustainable energies, or to manage their interface with investment policies, both nationally and internationally. For instance, in many national laws and international investment agreements there are foreign ownership (equity shares) limitations, particularly in some “sensitive” and/or “strategic” industries. However, in the context of market-harnessing industrial policy, does limiting equity ownership make sense – and, if so, under which conditions?

- Interaction with investment policies is also crucial in the field of **corporate governance and corporate social responsibility (CSR)**. Although there is an emerging trend in firms to be responsive not only to the interests of their shareholders, but also to a broader set of stakeholders, this trend is not widespread. Moreover, to date, there is no universally accepted CSR standard, and to the extent that standards exist, there is no effective monitoring or consistent reporting. Finally, there are questions about the adequate role of corporate self-regulation in situation, where governments’ regulatory and institutional frameworks are weak. All of these challenges touch on the very core of the “investment for development” paradigm.

- Finally, at a broader level, there is an important interface between **institutions, TNCs and development outcomes**. While institutions are widely recognized to have an important impact on a country’s ability to attract and benefit from FDI, effective institutions are largely absent, particularly in the developing world. It remains unclear why in some cases countries are successful in building institutions and increasing the value derived from FDI projects, while others fail. In this context, especially the two-way relationship between institutions and TNCs merits closer examination.

A recognition of the need to manage the interface between different policies at the national level, and an ability to do so, would
be an important step towards fostering the sustainability contribution of FDI.

4. Devising an international governance framework for responsible investment

In the absence of a global approach to investment and development [policies], the international investment relationship is governed by a highly atomized, multilayered and multifaceted regime, consisting of over 6,100 international investment agreements. Today’s fragmented regime lacks consistency between investment treaties, coherence between the national and international investment policies, and shows a limited ability to effectively deal with development concerns. Moreover, the international legal regime for FDI has so far focussed only on attracting investment, mainly by means of fostering the stability and predictability of the legal framework and by promoting investor rights.

- At the same time, there exist a number of instruments and initiatives aimed at fostering sustainable development. Important developments have occurred in international environmental and human rights law as well as in the field of corporate social responsibility. Similarly, international finance and trade regimes have evolved, and benefit from institutional structures such as the IMF and the WTO, respectively. There is no overarching approach, however, allowing policy makers to effectively harness potential synergies and minimize inconsistencies between the different international regimes.

- Moreover, a number of arbitral awards arising from the dispute settlement clauses typically included in IIAs have shown the very practical and immediate relationship between national and international policies. Amongst others, they have flagged the importance of designing international investment rules that effectively attract investment (including by ensuring investors rights and by fostering the stability and predictability of domestic legal frameworks), but without unduly constraining domestic regulatory prerogatives.
• While countries are addressing some of these systemic challenges by fixing their individual investment treaties and mechanisms, the longer-term solution lies in a global approach to investment for development. Above all, the world needs a sound international investment regime that effectively promotes sustainable development for all.

The above suggests to address investment policy challenges not only at the national level, but to recognize the linkages between national and international policies and to foster international cooperation towards realizing the potential of the novel investment for development paradigm.

5. Conclusions

In many ways the discussion above contains old issues. However, these issues remain unresolved and today, are qualitatively different because of the evolution of TNCs. They also need to be approached in the novel context of a rebalancing of public and private interests and the game-changing nature of policy challenges, such as climate change and food security confronting the world community (WIR 2010, epilogue). These developments not only pose challenges, but also create opportunities for governments to utilize TNCs as catalysts in the process of development, including by fostering “investment in the poor, for the poor and with the poor”.

The above recapitulation of policy and research issues underscores the challenging nature of the work ahead for UNCTAD and the research community as a whole. The ultimate goal of development nevertheless makes it all worthwhile. UNCTAD’s twenty years of experience garnered through successive World Investment Reports provides a valuable basis for this reassessment and rekindling of the agenda for policy-orientated research on investment for development. However, the endeavour must be a collaborative one, requiring interaction between different disciplines including, those related to development, business, law and others.

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4 See the article by Buckley (2010) in this issue.
FDI Trends and Prospects

Global foreign direct investment (FDI) witnessed a modest, but uneven recovery in the first half of 2010. This sparks some cautious optimism for FDI prospects in the short run and for a full recovery further on. UNCTAD expects global inflows to reach more than $1.2 trillion in 2010, rise further to $1.3–1.5 trillion in 2011, and head towards $1.6–2 trillion in 2012. However, these FDI prospects are fraught with risks and uncertainties, including the fragility of the global economic recovery.

Developing and transition economies attracted half of global FDI inflows, and invested one quarter of global FDI outflows. They are leading the FDI recovery and will remain favourable destinations for FDI.

Most regions are expected to see a rebound in FDI flows in 2010. The evolving nature and role of FDI varies among regions. Africa is witnessing the rise of new sources of FDI. Industrial upgrading through FDI in Asia is spreading to more industries and more countries. Latin American transnational corporations (TNCs) are going global. Foreign banks play a stabilizing role in South-East Europe, but their large scale presence also raises potential concerns. High levels of unemployment in developed countries triggered concerns about the impact of outward investment on employment at home.

Overcoming barriers for attracting FDI remains a key challenge for small, vulnerable and weak economies. Official development assistance (ODA) can act as a catalyst for boosting the role of FDI in least developed countries (LDCs). For landlocked developing countries (LLDCs) to succeed in attracting FDI they need to shift their strategy to focus on distance to markets rather than distance to ports. Focusing on
key niche sectors is crucial if small island developing States (SIDS) are to succeed in attracting FDI.

**Investment Policy Developments**

A dichotomy in investment policy trends is emerging. It is characterized by simultaneous moves to further investment liberalization and promotion on the one hand, and to increase investment regulation in pursuit of public policy objectives on the other.

Economic stimulus packages and state aid have impacted on foreign investment, with no significant investment protectionism observed so far.

The international investment agreement (IIA) universe is expanding rapidly, with over 5,900 treaties at present (on average four treaties signed per week in 2009). The IIA system is rapidly evolving as well, with countries actively reviewing and updating their IIA regimes, driven by the underlying need to ensure coherence and interaction with other policy domains (e.g. economic, social and environmental).

Global initiatives, such as investment in agriculture, global financial systems reform, and climate change are increasingly having a direct impact on investment policies.

**Investing in a Low-Carbon Economy**

TNCs are both major carbon emitters and low-carbon investors. They are therefore part of both the problem and the solution to climate change.

TNCs can contribute to global efforts for combating climate change by improving production processes in their operations at home and abroad, by supplying cleaner goods and services and by providing much-needed capital and cutting-edge technology.

UNCTAD estimates that in 2009 low-carbon FDI flows into three key low-carbon business areas (renewables, recycling and low-carbon technology manufacturing) alone amounted to $90 billion. In its totality such investment is much larger, taking into account embedded low-carbon investments in other industries and TNC participation through
non-equity forms. Already large, the potential for cross-border low-carbon investment is enormous as the world transitions to a low-carbon economy.

For developing countries, low-carbon foreign investment by TNCs can facilitate the expansion and upgrading of their productive capacities and export competitiveness, while helping their transition to a low-carbon economy. However, this investment also carries economic and social risks.

“Carbon leakage” has implications for both global emission reduction efforts and economic development. However, the extent of this phenomenon and its implications are hard to assess. Instead of addressing the issue at the border (as discussed in the current debate), it could be addressed at its source, working through corporate governance mechanisms, such as improved environmental reporting and monitoring.

Policy needs to maximize benefits and minimize risks related to low-carbon investment, based on individual countries’ social, economic and regulatory conditions.

To support global efforts to combat climate change, UNCTAD suggests a global partnership to synergize investment promotion and climate change mitigation and to galvanize low-carbon investment for sustainable growth and development. Elements of this partnership would be:

- **Establishing clean-investment promotion strategies.** This encompasses developing conducive host-country policy frameworks (including market-creation mechanisms) and implementing effective promotion programmes (with key functions being investor targeting, fostering linkages and investment aftercare). International financial institutions and home countries need to support low-carbon investment promotion strategies, in particular through outward investment promotion, investment guarantees and credit risk guarantees.

- **Enabling the dissemination of clean technology.** This involves putting in place an enabling framework to facilitate cross-border technology flows, fostering linkages between TNCs and local firms.
to maximize spillover effects, enhancing local firms’ capacities to be part of global value chains, strengthening developing countries’ absorptive capacity for clean technology, and encouraging partnership programmes for technology generation and dissemination between countries.

- **Securing IIAs’ contribution to climate change mitigation.** This includes introducing climate-friendly provisions (e.g. low-carbon investment promotion elements, environmental exceptions) into future IIAs, and a multilateral understanding to ensure the coherence of existing IIAs with global and national policy developments related to climate change.

- **Harmonizing corporate GHG emissions disclosure.** This involves creating a single global standard for corporate greenhouse gas (GHG) emissions disclosure, improving the disclosure of foreign operations and activities within value chains, and mainstreaming best practices in emissions disclosure via existing corporate governance regulatory mechanisms (such as stock-listing requirements).

- **Setting up an international low-carbon technical assistance centre (L-TAC).** L-TAC could support developing countries, especially LDCs, in formulating and implementing national climate change mitigation strategies and action plans, as well as engage in capacity and institution building. The centre would help beneficiaries meet their development challenges and aspirations, including by benefiting from low-carbon foreign investment and associated technologies. Among others, L-TAC would leverage expertise via existing and novel channels, including multilateral agencies.

**Investment for Development: Challenges Ahead**

The evolving TNC universe, along with the emerging investment policy setting, poses three sets of key challenges for investment *for development*:

- to strike the right policy balance (liberalization vs. regulation; rights and obligations of the State and investors);
• to enhance the critical interfaces between investment and development, such as those between foreign investment and poverty, and national development objectives;

• to ensure coherence between national and international investment policies, and between investment policies and other public policies.

All this calls for a new investment-development paradigm and a sound international investment regime that effectively promotes sustainable development for all.
Global foreign direct investment (FDI) flows began to bottom out in the latter half of 2009. This was followed by a modest recovery in the first half of 2010, sparking some cautious optimism for FDI prospects in the short term (fig. 1). In the longer term, the recovery in FDI flows is set to gather momentum (fig. 2). Global inflows are expected to pick up to over $1.2 trillion in 2010, rise further to $1.3–1.5 trillion in 2011, and head towards $1.6–2 trillion in 2012. However, these FDI prospects are fraught with risks and uncertainties, including the fragility of the global economic recovery.

The current FDI recovery is taking place in the wake of a drastic decline in FDI flows worldwide in 2009. After a 16 per cent decline in 2008, global FDI inflows fell a further 37 per cent to $1,114 billion, while outflows fell some 43 per cent to $1,101 billion.

There are some major changes in global FDI patterns that preceded the global crisis and that will most likely gain momentum in the short and medium term. Firstly, the relative weight of developing and transition economies as both destinations and sources of global FDI is expected to keep increasing. These economies, which absorbed almost half of FDI inflows in 2009, are leading the FDI recovery. Secondly, the recent further decline in manufacturing FDI, relative to that in the services and primary sectors, is unlikely to be reversed. Thirdly, in spite of its serious impact on FDI, the crisis has not halted the growing internationalization of production.

**Figure 1. Global FDI Quarterly Index, 2000 Q1–2010 Q1**
(Base 100: quarterly average of 2005)

FDI: on the way to recovery

All the components of FDI flows – equity investment, intra-company loans and reinvested earnings – contracted in 2009. Depressed levels of cross-border merger and acquisition (M&A) transactions, as well as the lower profits of foreign affiliates, had a heavy effect on equity investments and reinvested earnings. Improved corporate profits have, however, supported a modest recovery in reinvested earnings since the second half of 2009. FDI showed renewed dynamism in the first quarter of 2010. Cross-border M&As – still low at $250 billion in 2009 – rose by 36 per cent in the first five months of 2010 compared to the same period in the previous year.

The slump in cross-border M&As accounts for most of the FDI decline in 2009. Acquisitions abroad contracted by 34 per cent (65 per cent in value), as compared to a 15 per cent retrenchment in the number of greenfield FDI projects. M&As are usually more sensitive to financial conditions than greenfield projects. This is because turmoil in stock markets obscures the price signals upon which M&As rely, and because the investment cycles of M&As are usually shorter than those of greenfield investments. The global crisis curtailed the funding available for FDI, reducing the number of acquisitions. While depressed stock prices reduced the value of transactions, together with global restructuring they also created opportunities for the TNCs that were still
able to access finance. Although FDI flows through both entry modes are showing signs of recovery in 2010, M&As are rebounding faster.

FDI declined across all three sectors—the primary, manufacturing and services sectors. Cyclical industries such as the automotive and chemical industries were not the only victims. FDI in industries that were initially resilient to the crisis—including pharmaceuticals and food processing—was also hit in 2009. Only a handful of industries attracted more FDI in 2009 than in 2008, namely electricity, gas and water distribution, as well as electronic equipment, construction and telecommunications. In all, FDI in the manufacturing sector was the worst affected, reflected in a decline of 77 per cent in cross-border M&As compared to 2008. The contraction in such transactions in the primary and services sectors was less severe—at 47 per cent and 57 per cent respectively. This continued to push up their relative weights in global cross-border M&As at the expense of manufacturing. Yet some industries in these sectors were severely affected too: notably, the value of cross-border M&A transactions in financial services collapsed by 87 per cent.

FDI by private equity funds decreased by 65 per cent in terms of value, while FDI from sovereign wealth funds (SWFs) rose by 15 per cent in 2009. These funds together accounted for over one tenth of global FDI flows, up from less than 7 per cent in 2000 but down from 22 per cent in the peak year of 2007. FDI by private equity funds was affected both by the drop in their fund-raising and by the collapse of the leveraged buyout market. The value of cross-border M&As by private equity funds went down to $106 billion in 2009, or less than a quarter of its 2007 peak value. Nevertheless, smaller transactions exhibited resilience, and the number of acquisitions involving private equity funds actually increased. Private equity activity is showing signs of recovery in 2010, but proposed regulation in the European Union (EU) may restrict future transactions. Funding for SWFs also suffered in 2009, due to declines in commodity prices and trade surpluses. Yet their FDI activity did not decline, reflecting the relatively high growth of the emerging economies that own these funds. New investments were redirected towards the primary sector and industries less vulnerable to financial developments as well as developing regions.
Further internationalization of firms

Despite its impact on FDI flows, the global crisis has not halted the growing internationalization of production. The reduction in sales and in the value-added of foreign affiliates of transnational corporations (TNCs) in 2008 and 2009 was more limited than the contraction of the world economy. As a result, foreign affiliates’ share in global gross domestic product (GDP) reached an historic high of 11 per cent (table 1). TNCs’ foreign employment increased slightly in 2009, to 80 million workers. The rise of developing and transition economies is apparent in international production patterns. These economies now host the majority of foreign affiliates’ labour force. In addition, they accounted for 28 per cent of the 82,000 TNCs worldwide in 2008, two percentage points higher than in 2006. This compares to a share of less than 10 per cent in 1992, and reflects their growing importance as home countries as well.

Foreign affiliates’ assets grew 7.5 per cent in 2009, thanks largely to the 15 per cent rise in inward FDI stock to $18 trillion. The increase in FDI stock was due to a significant rebound of global stock markets as well as continued investment inflows of FDI, which remained positive but expanded at a much reduced pace than before.

Half of global FDI inflows now go to developing and transition economies

FDI inflows to developing and transition economies declined by 27 per cent to $548 billion in 2009 (table 2), following six years of uninterrupted growth. While their FDI contracted, this grouping appeared more resilient to the crisis than developed countries, as their decline was smaller than that for developed countries (44 per cent) (table 2). Their share in global FDI inflows kept rising: for the first time ever, developing and transition economies are now absorbing half of global FDI inflows (fig. 3).

Following a five-year upward trend, FDI outflows from developing and transition economies contracted by 21 per cent in 2009. However, with the rise of TNCs from those economies, the FDI contraction was also more muted than in developed countries, where FDI outflows shrank by
48 per cent (table 2). FDI is also rebounding faster in the developing world. The share of their outward investment remains much smaller, but it is accelerating and reaching a quarter of global outflows (fig. 3).

Among the largest FDI recipients, China rose to second place after the United States in 2009. Half of the six top destinations for FDI flows are now developing or transition economies (fig. 4). Over two thirds of cross-border M&A transactions still involve developed countries, but the share of developing and transition economies as hosts to those transactions has risen from 26 per cent in 2007 to 31 per cent in 2009. In addition, this grouping attracted more than 50 per cent of greenfield projects in 2009. On the outward investment side, Hong Kong (China), China and the Russian Federation, in that order, are among the top 20 investors in the world (fig. 4).

<table>
<thead>
<tr>
<th>Item</th>
<th>Value at current prices (Billions of dollars)</th>
<th>Annual growth rate (Per cent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FDI inflows</td>
<td>208</td>
<td>986</td>
</tr>
<tr>
<td>FDI outflows</td>
<td>241</td>
<td>893</td>
</tr>
<tr>
<td>FDI inward stock</td>
<td>2,082</td>
<td>11,525</td>
</tr>
<tr>
<td>FDI outward stock</td>
<td>2,087</td>
<td>12,417</td>
</tr>
<tr>
<td>Income on inward FDI</td>
<td>74</td>
<td>791</td>
</tr>
<tr>
<td>Income on outward FDI</td>
<td>120</td>
<td>902</td>
</tr>
<tr>
<td>Cross-border M&amp;As</td>
<td>99</td>
<td>462</td>
</tr>
<tr>
<td>Sales of foreign affiliates</td>
<td>6,026</td>
<td>21,721</td>
</tr>
<tr>
<td>Gross product of foreign affiliates</td>
<td>1,477</td>
<td>4,327</td>
</tr>
<tr>
<td>Total assets of foreign affiliates</td>
<td>5,938</td>
<td>49,252</td>
</tr>
<tr>
<td>Exports of foreign affiliates</td>
<td>1,498</td>
<td>4,319</td>
</tr>
<tr>
<td>Employment by foreign affiliates (thousands)</td>
<td>24,476</td>
<td>57,799</td>
</tr>
</tbody>
</table>

**Memorandum**

| GDP (in current prices) | 22,121 | 45,273 | 60,766 | 55,005 | 5.9 | 1.3 | 10.0 | 10.3 | -9.5 |
| Gross fixed capital formation  | 5,099 | 9,833 | 13,822 | 12,404 | 5.4 | 1.1 | 11.0 | 11.5 | -10.3 |
| Royalties and licence fee receipts | 29 | 129 | 177 | .. | 14.6 | 8.1 | 14.6 | 8.6 | .. |
| Exports of goods and services  | 4,414 | 12,954 | 19,986 | 15,716 | 7.9 | 3.7 | 14.8 | 15.4 | -21.4 |

Uneven performance in FDI across regions

As highlighted by some of the data presented above, the global picture of FDI flows belies a more varied regional reality. Most FDI in developing and transition economies has flowed to a small number of countries, mainly large emerging markets.

Following almost a decade of uninterrupted growth, FDI flows to Africa fell to $59 billion – a 19 per cent decline compared to 2008 (table

<table>
<thead>
<tr>
<th>Region</th>
<th>FDI inflows</th>
<th>FDI outflows</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2007</td>
<td>2008</td>
</tr>
<tr>
<td>World</td>
<td>2 100</td>
<td>1 771</td>
</tr>
<tr>
<td>Developed economies</td>
<td>1 444</td>
<td>1 018</td>
</tr>
<tr>
<td>Developing economies</td>
<td>565</td>
<td>630</td>
</tr>
<tr>
<td>Africa</td>
<td>63</td>
<td>72</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>164</td>
<td>183</td>
</tr>
<tr>
<td>West Asia</td>
<td>78</td>
<td>90</td>
</tr>
<tr>
<td>South, East and South-East Asia</td>
<td>259</td>
<td>282</td>
</tr>
<tr>
<td>South-East Europe and the CIS</td>
<td>91</td>
<td>123</td>
</tr>
<tr>
<td>Structurally weak, vulnerable and small economies (a)</td>
<td>42.5</td>
<td>62.1</td>
</tr>
<tr>
<td>LDCs</td>
<td>26</td>
<td>32</td>
</tr>
<tr>
<td>LLDCs</td>
<td>16</td>
<td>26</td>
</tr>
<tr>
<td>SIDS</td>
<td>5</td>
<td>8</td>
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</tbody>
</table>

Memorandum: percentage share in world FDI flows

<table>
<thead>
<tr>
<th>Region</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed economies</td>
<td>68.8</td>
<td>57.5</td>
<td>50.8</td>
<td>84.8</td>
<td>81.5</td>
<td>74.5</td>
</tr>
<tr>
<td>Developing economies</td>
<td>26.9</td>
<td>35.6</td>
<td>42.9</td>
<td>12.9</td>
<td>15.4</td>
<td>20.8</td>
</tr>
<tr>
<td>Africa</td>
<td>3.0</td>
<td>4.1</td>
<td>5.3</td>
<td>0.5</td>
<td>0.5</td>
<td>0.5</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>7.8</td>
<td>10.3</td>
<td>10.5</td>
<td>2.5</td>
<td>4.3</td>
<td>4.3</td>
</tr>
<tr>
<td>West Asia</td>
<td>3.7</td>
<td>5.1</td>
<td>6.1</td>
<td>2.1</td>
<td>2.0</td>
<td>2.1</td>
</tr>
<tr>
<td>South, East and South-East Asia</td>
<td>12.3</td>
<td>15.9</td>
<td>20.9</td>
<td>7.9</td>
<td>8.6</td>
<td>13.9</td>
</tr>
<tr>
<td>South-East Europe and the CIS</td>
<td>4.3</td>
<td>6.9</td>
<td>6.3</td>
<td>2.3</td>
<td>3.1</td>
<td>4.6</td>
</tr>
<tr>
<td>Structurally weak, vulnerable and small economies (a)</td>
<td>2.0</td>
<td>3.5</td>
<td>4.5</td>
<td>0.2</td>
<td>0.3</td>
<td>0.4</td>
</tr>
<tr>
<td>LDCs</td>
<td>1.2</td>
<td>1.8</td>
<td>2.5</td>
<td>0.1</td>
<td>0.2</td>
<td>0.1</td>
</tr>
<tr>
<td>LLDCs</td>
<td>0.7</td>
<td>1.5</td>
<td>2.0</td>
<td>0.2</td>
<td>0.1</td>
<td>0.3</td>
</tr>
<tr>
<td>SIDS</td>
<td>0.3</td>
<td>0.4</td>
<td>0.4</td>
<td>0.0</td>
<td>0.0</td>
<td>0.0</td>
</tr>
</tbody>
</table>


Without double counting as a number of countries belong to two of these three groups.
2) – mainly due to contraction in global demand and falling commodity prices. Commodities producers in West and East Africa were affected. Flows to North Africa also declined despite its more diversified FDI and sustained privatization programmes. Contraction of investment in the services sector in Africa was less pronounced than in other sectors. Sustained by expanded activity, the telecommunications industry became the largest recipient of FDI inflows. Recovering commodity prices and continued interest from emerging Asian economies are expected to feed a slow upturn in FDI flows to Africa in 2010.

TNCs from developing and transition economies have increasingly been investing in Africa over the past few years. They accounted for 22 per cent of flows to the region over the 2005–2008 period, compared to 18 per cent in 1995–1999. Investors from China, Malaysia, India and the Gulf Cooperation Council (GCC) are among the most active – although Africa still makes up only a fraction of their FDI. Investors from Southern Africa and North Africa have also raised their profile in the region. These new sources of investment not only provide additional development opportunities, but are also expected to be more resilient than traditional ones, providing a potential buffer against crises.

**Figure 3. Shares of developing and transition economies in global FDI inflows and outflows, 2000–2009**

(Per cent)


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Transnational Corporations, Vol. 19, No. 2 (August 2010)
Figure 4. Global FDI flows, top 20 economies, 2008–2009
(Billions of dollars)

* Ranked on the basis of the magnitude of 2009 FDI flows.
Outward investment from Africa as a whole contracted by half, to $5 billion. Outflows from Southern Africa, however, expanded to $1.6 billion in 2009, boosted by South African investment, mainly in the rest of Africa. Nevertheless, North Africa remained the largest source of regional outflows, accounting for over 50 per cent of the total.

FDI flows to South, East and South-East Asia have experienced their largest decline since 2001, but they are the first to bottom out from the current downturn. Inflows to the region dropped by 17 per cent in 2009, to $233 billion (table 2), mainly reflecting a decline in cross-border M&As, which was particularly severe in services (-51 per cent). As investment from developed countries plummeted, intraregional FDI gained ground and now accounts for as much as half of the region’s inward FDI stock. Total outflows from the region declined by 8 per cent to $153 billion, with cross-border M&A purchases dropping by 44 per cent. Against these trends China’s outward investment in the non-financial sector continued to expand, driven by a continued search for mineral resources and for the M&A opportunities created by global industrial restructuring.

FDI in South, East and South-East Asia has already started rebounding, and is likely to pick up speed as the region plays a leading role in the global economic recovery. In particular, inflows to China and India started picking up as early as mid-2009, and their sustained FDI outflows are expected to drive the region’s outward investment back to growth in 2010. Recovery of FDI in and from the four newly industrializing economies (Hong Kong (China), Republic of Korea, Singapore and Taiwan Province of China), however, is likely to be slow and modest.

Growing intraregional investment in Asia has served as a vehicle for technology diffusion, “recycling” of comparative advantages and competitiveness enhancement. It has been instrumental in the sequential upgrading of industries across countries at various stages of development. Regional integration and China’s take-off are now accelerating this process, creating development opportunities for a wider range of countries, including LDCs such as Cambodia, the Lao People’s Democratic Republic and Myanmar. In addition, this process of sequential upgrading has expanded beyond industries such as electronics, and more high-tech products have been involved.
The tightening of international credit markets and the decline of international trade impacted FDI flows to West Asia, which contracted by 24 per cent to $68 billion in 2009 (table 2). Except in the case of Kuwait, Lebanon and Qatar, inward FDI declined across the region. The contraction hit Turkey and the United Arab Emirates the hardest. In Turkey, cross-border M&As plummeted, and export-oriented industries suffered from the impact of the global crisis. FDI outflows from the region, 87 per cent of which are generated from the countries of the GCC, declined by 39 per cent to $23 billion. Rising outward investment from Saudi Arabia was not enough to compensate for the negative impact of the Dubai World crisis. Provided that this crisis abates and international credit markets stabilize, West Asian Governments’ sustained commitment to ambitious infrastructure plans is expected to support a recovery in FDI inflows in 2010. Outward investment, on the other hand, will remain subdued in the short term. State-owned entities – the region’s main investors – have refocused their attention on their domestic economies, and the Dubai World crisis will continue to weigh on the outward FDI of the United Arab Emirates.

The impact of the global economic and financial turmoil drove FDI to Latin America and the Caribbean down to $117 billion – a 36 per cent decline from the 2008 level (table 2). Although Brazil, with a 42 per cent contraction in inward investment, was more affected than the region as a whole, it remained the largest FDI recipient. Cross-border M&As in the region collapsed, turning negative in 2009 due to sales of foreign affiliates to domestic companies, particularly in Brazil. FDI inflows are expected to recover in 2010 and to continue growing in the medium term, as Brazil and Mexico remain popular investment destinations, according to investor surveys.

Brazil’s outward FDI swung to a negative $10 billion, due to a surge in intra-company loans from Brazilian affiliates abroad to their parent companies. This resulted in a 42 per cent decline in the region’s outward investment. Nevertheless, cross-border M&A purchases by TNCs from the region, directed mainly at developed countries, rose by 52 per cent to $3.7 billion. The continued emergence of the region’s TNCs, which began in 2003, will drive outward FDI in the medium term. FDI outflows from Latin America and the Caribbean leaped from an average of $15 billion a year in 1991–2000 to $48 billion annually in 2003–2009. An increasing number of Latin American companies –
mostly Brazilian and Mexican – have been expanding outside the region, primarily into developed economies.

Besides favourable economic conditions in the region since 2003, government policies also contributed to the consolidation of domestic firms at home and their further outward expansion. The region’s main foreign investors today are often the largest and oldest business groups that prospered during the import substitution era. Moreover, privatization policies in countries such as Brazil and Mexico have resulted in the creation of national champions. More recently, government incentives in Brazil, including targeted credit lines, have supported companies’ outward expansion. Limited access to domestic financing, coupled with the current tight international financial markets, could hinder further expansion, however. These TNCs will continue to benefit from their low debt-to-earnings ratio, limited exposure to the industries most affected by the crisis, and the relative resilience of the region’s economy.

After an eight-year upward trend, FDI inflows to South-East Europe and the Commonwealth of Independent States (CIS) shrank to $69.9 billion, a 43 per cent decline from 2008 (table 2). FDI inflows to both subregions dropped in 2009, although flows to South-East Europe were less affected than those to the CIS. FDI flows to the Russian Federation almost halved, due to sluggish local demand, declining expected returns in projects related to natural resources, and the drying-up of round-tripping FDI. Nevertheless, the Russian Federation ranked sixth in the global ranking of top locations in 2009. Cross-border M&As collapsed due to sluggish acquisitions by firms from the EU, the largest investors in the region. Investments from developing countries, China in particular, were on the rise, though. The contraction of FDI outflows from the region (-16 per cent) was not as severe as the decline in inflows. In 2009, the Russian Federation – by far the largest source of outward FDI from the region – became a net outward investor. Stronger commodity prices, a new round of privatization, and economic recovery in large commodity-exporting countries (Kazakhstan, the Russian Federation and Ukraine) should support a modest recovery in FDI in the region in 2010.

FDI in South-East Europe’s banking industry has been on the rise since the early years of the new millennium, fuelled by substantial
restructuring and privatization. As a result, 90 per cent of banking assets were owned by foreign entities at the end of 2008. Foreign banks have played a positive role in the region during the global financial crisis. The recent sovereign debt crisis in Greece, however, is reviving concerns that the large presence of foreign banks could channel systemic risks to the region.

FDI flows to developed countries suffered the worst decline of all regions, contracting by 44 per cent to $566 billion (table 2). However, this setback was not as pronounced as during the previous economic downturn of 2000–2003, even though the current economic and financial turmoil is far more severe. North America was the worst affected, while the 27 member countries of the EU weathered the blow better with Germany, for example, recording a 46 per cent increase, mainly due to an upswing in intra-company loans. On the other hand, FDI flows to the United Kingdom, another major host country in the region, shrank by 50 per cent compared to the previous year. Cross-border M&As dropped by two thirds in developed countries, with transactions in the manufacturing sector contracting by about 80 per cent.

A modest economic recovery stabilized inward investment in the first half of 2010 and is expected to push FDI inflows to developed countries to above their 2009 levels. Ongoing liberalization in areas such as electricity, further regional integration, and continued interest from TNCs based in developing and transition economies should all contribute to better FDI prospects for the developed countries in the medium term. Outward FDI, after falling 48 per cent in 2009, is also expected to recover in 2010 and pick up pace in the medium term, supported by the improving global economic prospects, in particular in the developing world. However, the perception of increased risk of sovereign debt default in certain European countries and its possible further spread in the eurozone could easily disrupt this upward trend.

The economic downturn has revived long-standing concerns in developed countries over the impact of the growing internationalization of production on home country employment. Rapid growth of outward FDI over the past decade has resulted in a growing share of developed-country TNCs’ employment moving abroad. And yet, FDI can save or expand domestic employment if it results in exports for the home
country or improved competitiveness for investing firms. Research has produced mixed evidence on the impact of outward FDI on domestic job reduction. Indeed, the impact depends on the type of investment, the location of affiliates and TNCs’ employment strategies.

Small and vulnerable economies

The decline in FDI to weak, vulnerable and small country groupings – LDCs, LLDCs and SIDS – is of particular concern given its role in these countries’ economies. The level of FDI compared to their gross fixed capital formation was equivalent to between 25 per cent and 40 per cent in 2009 across these groupings, which was much higher than in other parts of the world. While FDI is concentrated in natural resources in terms of value in these groups, FDI is diversified in manufacturing and services sectors as well judging by the number of such projects. Their share in global FDI inflows was only 4 per cent (table 2).

FDI flows to the 49 least developed countries (LDCs) declined by 14 per cent to $28 billion. The impact of lower inward investment is particularly serious for this group of countries, as the high ratio of FDI to their gross fixed capital formation (24 per cent in 2009) suggests that it is a major contributor to capital formation. FDI inflows to LDCs still account for only 3 per cent of global FDI inflows and 6 per cent of flows to the developing world. FDI remains concentrated in a few countries that are rich in natural resources. Greenfield investments account for the bulk of FDI in LDCs, and over 60 per cent of such projects originated from developing and transition economies in 2009. Most FDI inflows to the group still originate from developed countries. FDI prospects over the medium term depend on the extent to which LDCs’ structural weaknesses are overcome. These disadvantages could be partly mitigated if official development assistance (ODA) were to be used more effectively, with a view to boosting the productive capacity of the host country in order to leverage FDI for development.

The 31 landlocked developing countries (LLDCs) have not traditionally been seen as attractive FDI destinations. Inherent geographical disadvantages compounded by structural weaknesses have hampered their economic performance. And yet economic reforms, investment liberalization and favourable global economic conditions had translated into a steady increase in FDI inflows during
2000–2008. The 17 per cent decline in FDI to $22 billion in 2009 was less pronounced than in the rest of the world. Due to the lack of diversification of productive capacities, FDI to LLDCs remained concentrated in the primary sector of a few resource-rich countries (Kazakhstan alone received 58 per cent of the total in 2009). FDI to LLDCs, which originates primarily from developing economies, especially from Asia and Africa, is expected to pick up only slowly. In order to overcome their geographical challenges, LLDCs could focus on industries that have a higher knowledge and information content and that are less reliant on the use of inputs involving transportation costs. Regional integration involving non-landlocked countries could also make these economies more attractive investment destinations, by expanding the size of local markets.

The 29 small island developing States (SIDS) have also struggled to attract FDI. The small size of their domestic markets, limited natural and human resources, and high transaction costs such as those for transport, have discouraged FDI. However, in spite of its 35 per cent decline to $5 billion in 2009, the ratio of FDI flows to gross fixed capital formation remained above 30 per cent, as domestic investment contracted even more. Half of the grouping’s total FDI inflows were concentrated in the top three SIDS investment destinations (Jamaica, Trinidad and Tobago, and the Bahamas, in that order). Tax-haven SIDS accounted for about one quarter of both FDI inflows and stocks in 2009, but stricter international regulations are gradually eroding inward FDI to those economies. Given their geographical limitations, SIDS are expected to continue to rely on their potential in traditional niche services such as tourism. Knowledge-based industries also offer promising potential, provided that SIDS develop adequate information technology and telecommunications infrastructure and improve their human capital.

FDI prospects: a cautious optimism

UNCTAD estimates that global FDI flows will slightly recover to reach over $1.2 trillion in 2010, before picking up further to $1.3–1.5 trillion in 2011. Only in 2012 is FDI expected to regain its pre-crisis level, with a range estimated at $1.6–2 trillion. The gradual improvement of macroeconomic conditions, corporate profits and stock market valuations observed in early 2010 is expected to continue, supporting
renewed business confidence. After a contraction of 2 per cent in 2009, the global economy is projected to grow by 3 per cent in 2010. Both interest rates and commodity prices will most likely remain moderate until the end of the year, helping to keep production costs under control and supporting domestic investment. Corporate profits have been recovering since mid-2009 and are expected to pick up in 2010. Together with better stock market performance, this will support financing for FDI.

UNCTAD’s *World Investment Prospects Survey 2010–2012* indicates renewed business optimism over the medium term. TNCs’ intentions to pursue foreign expansion are stronger for 2011 and 2012. The recovery of FDI is likely to be led by cross-border M&As. Restructuring in a number of industries, as well as the privatization of companies rescued during the global turmoil, will further create cross-border M&A opportunities for TNCs. The survey also confirms that the share of the manufacturing sector in FDI will continue to decline relative to the primary and services sectors.

TNCs from developing economies are more optimistic than their counterparts from developed countries, and expect that their foreign investments will recover faster. This suggests a continued expansion of emerging TNCs as a source of FDI. In addition, global investors show an ever-growing interest in developing economies. Brazil, the Russian Federation, India and China (BRIC), in particular, are bright spots for FDI. Flows to developing and transition economies will not only be directed at the most labour-intensive parts of the value chain, but increasingly at more technology-intensive activities.

The global financial and economic recovery remains fragile, threatened by emerging risks, constraints in public investment, uncertainty about financial regulatory reforms, the limited access to credit, the volatility of the stock and foreign exchange markets and other factors. For the recovery to remain on track, private investment is crucial for stimulating growth and employment. FDI has a major role to play.

At present, cautious optimism prevails regarding prospects for global FDI.
RECENT POLICY DEVELOPMENTS

Current investment policy trends can be generally characterized by further liberalization and facilitation of foreign investment. At the same time, efforts to regulate foreign investment to advance public policy objectives (e.g. protection of the environment, alleviation of poverty, and/or addressing national security concerns) have intensified. This dichotomy in policies and the political will to rebalance the respective rights and obligations of the State and investors are becoming apparent at both the domestic and international policy levels, with emphasis swinging towards the role of the State. The network of international investment agreements (IIAs) has expanded further, while attempts to ensure balance and coherence within the IIA regime are under way. Furthermore, investment policymaking is attempting to reflect the closer interaction between investment policies and other policies, including those relating to broader economic, social and environmental issues.

National policies: regulation gaining ground, as liberalization continues

National investment regimes continued to become more favourable towards foreign investment, while governments have increasingly re-emphasized regulation.

Out of the 102 new national policy measures affecting foreign investment that were identified in 2009, the majority (71) were in the direction of further liberalization and promotion of foreign investment (fig. 5). This confirms that the global economic and financial turmoil has so far not resulted in heightened investment protectionism. Policies included, inter alia, the opening of previously closed sectors, the liberalization of land acquisition, the dismantling of monopolies, and the privatization of state-owned enterprises. Measures to promote and facilitate investments focused on fiscal and financial incentives to encourage FDI in particular industries or regions, including special economic zones; easing screening requirements; streamlining approval procedures; or accelerating project licensing. To improve the business climate, corporate tax rates were also lowered in a number of countries, particularly in developed countries and developing economies in Africa and Asia. Growing fiscal strains may eventually result in a reversal in the trend observed over the past decade, however.
In spite of the general trend toward liberalization, 31 of the new national policy measures were towards tighter regulations for FDI. Accounting for over 30 per cent of the total, this is the highest share of such measures observed since 1992, when UNCTAD started reporting these measures. These measures are driven in part by increased concern over the protection of strategic industries, national resources and national security. Recent crises, such as the turmoil in the financial markets and the impact of rising food prices, have also translated into a will to regulate specific industries. Lastly, emerging economies are giving more weight to environmental and social protection, while LDCs are filling gaps in their regulatory frameworks. As a result, new limitations on foreign participation were introduced in some industries, or procedures for the screening and approval of investments were tightened, sometimes on national security grounds. Greater state intervention in the economy was most obvious in expropriations – which occurred in a few Latin American countries – and an increase, in state participation in companies as part of financial bailout measures.

The expected reversal of temporary nationalizations in sectors often considered as strategic could result in governments pushing to have privatized companies remain in domestic hands, or pressuring investors to keep production and jobs at home. As a result, the phasing out of rescue packages will need to be closely monitored, as risks of investment protectionism have not disappeared.
Thirteen G20 countries continue to carry outstanding assets and liabilities left as a legacy of emergency schemes. The total amount of public commitments – equity, loans and guarantees – on 20 May 2010 exceeded $1 trillion. In the financial sector, several hundred firms continue to benefit from such public support, and in non-financial sectors, at least 20,000 individual firms continue to benefit from emergency support programmes.

The international investment regime: towards a more balanced approach

The international investment regime expanded in scale and scope, and a systemic evolution towards a regime that is more balanced in terms of the rights and obligations of States and investors is taking shape.

The international investment regime is evolving rapidly through both the conclusion of new treaties and an increasing number of arbitral awards. In 2009, 211 new IIAs were concluded (82 bilateral investment treaties (BITs), 109 double taxation treaties (DTTs) and 20 other IIAs) – on average about four new agreements per week. In all, the total number of agreements rose to 5,939 at the end of the year (fig. 6). The trend towards rapid treaty-making continued in 2010, with the first five months seeing the conclusion of 46 more IIAs (6 BITs, 33 DTTs and 7 other IIAs). A major recent development occurred in Europe, where the Lisbon Treaty transferred FDI competencies from member States to the EU. As for investor-state dispute settlements, at least 32 new cases were initiated in 2009 and 44 decisions rendered, bringing the total of known cases ever filed to 357, and those concluded to 164 by the end of the year. The overwhelming majority of these 357 cases were initiated by investors from developed countries, with developing and transition countries most often on the receiving end. Some arbitral awards resulted in inconsistencies and lack of coherence between arbitral decisions.

Regional integration – as well as the need to promote coherence and reflect broader policy considerations in IIAs – is driving systemic changes in the international investment regime, creating the opportunity for a more coherent, balanced, development-friendly and effective international investment regime. The IIA landscape appears
to be consolidating through (a) an increase in broader plurilateral economic agreements that include investment provisions; (b) efforts to create regional (mainly South-South) investment areas; (c) the competence shift concerning foreign investment within the EU; (d) the abrogation of BITs to streamline the treaty landscape and eliminate contradictions with other legal instruments; and (e) efforts by numerous countries to reassess their international investment policies to better align them with development considerations by revising their model BITs, reviewing their respective treaty networks and their development implications, or denouncing their BITs.

In addition, many recent treaties, whether new, renegotiated or revised, suggest that governments, developed and developing countries alike, are increasingly seeking to formulate agreements more precisely, by clarifying the scope of treaties or the meaning of specific obligations, in order to preserve States’ right to regulate. Environmental clauses, as well as clauses seeking to ensure appropriate corporate behaviour in areas such as social practices, are becoming increasingly common, too. Making IIAs work effectively for development remains a challenge, however.

Although international investment arbitration remains the main avenue for resolving investment disputes, systemic challenges are increasingly becoming apparent in the dispute settlement system. As a result, a number of countries have been refining the investor-state
dispute settlement provisions in their IIAs, seeking to reduce their exposure to investor claims or increase the efficiency and legitimacy of the dispute settlement process. In addition, several sets of international arbitration rules – including those of the International Centre for Settlement of Investment Disputes (ICSID), the International Chamber of Commerce (ICC) and the United Nations Commission on International Trade Law (UNCITRAL) – have been or are being revised. At the same time, a few developing countries are turning away from international arbitration processes, denouncing the ICSID Convention or looking into alternative dispute resolution and prevention mechanisms.

Other investment-related initiatives

Besides investment treaties, recent policy initiatives to deal with global challenges also have implications for international investment.

Several efforts have been launched to establish international principles for responsible investment in agriculture. These include a joint initiative on promoting responsible agricultural investment, jointly spearheaded by UNCTAD, the Food and Agriculture Organization of the United Nations, the International Fund for Agricultural Development and the World Bank Group. Such principles, if embraced and implemented, could enhance the benefits of FDI in agriculture while mitigating its potential downsides, thereby contributing to strengthening food security and local development.

The members of the G20 committed themselves to refraining from protectionism in the area of trade and investment, and asked intergovernmental organizations, including UNCTAD, to monitor and publicly report on developments related to trade and investment protectionism.

Efforts are also under way, both at the national and the multilateral level, to reform the financial system and address the weaknesses that underpinned the global financial crisis. These will have significant implications for FDI flows. Attention needs to be given to coherence between the emerging international financial system and the international investment system, the interaction of which has been largely neglected. While the two systems have developed in parallel, both govern short- and long-term cross-border capital flows.
TNCs are a part of both the problem and the solution

The global policy debate on tackling climate change is no longer about whether to take action. It is now about how much action to take and which actions need to be taken – and by whom. The global scale of the challenge in reducing greenhouse gas (GHG) emissions requires an equivalent and enormous financial and technological response. TNCs have an indispensable contribution to make in the shift towards a low-carbon economy, because they are significant emitters across their vast international operations, but also because they are in a prime position to generate and disseminate technology and to finance investments to mitigate GHG emissions. Inevitably, TNCs are a part of both the problem and the solution.

For 2010–2015, one estimate indicates that $440 billion of recurring additional global investments per year are required to limit GHG emissions to the level needed for a 2 °C target to be met (as referred to in the Copenhagen Accord). By 2030, the estimates range even higher, up to $1.2 trillion per year. All studies emphasize that the financial contribution of the private sector is essential for achieving progress in making economies worldwide more climate-friendly, particularly in view of the huge public fiscal deficits worldwide. To combat climate change, low-carbon policies aimed at TNCs and foreign investment therefore need to be incorporated into national economic and development strategies.

The need for effective mechanisms to mobilize the private sector

The current international climate change regime has not encouraged low-carbon foreign investment and related technology flows (particularly into poor developing economies) as much as was hoped for, despite recent increases. Following the Copenhagen meeting in December 2009, future emission targets, the nature of
the institutions, concrete policy mechanisms and sources of funding continue to be unclear. The main international policy effort so far remains the Kyoto Protocol, the prospects for which are unclear. The current climate change regime is thus failing to generate what the private sector most needs in order to reorient its business strategies: a clear, stable and predictable policy framework.

The Kyoto Protocol has been praised for creating mechanisms to reduce emissions, including the Clean Development Mechanism, which is also seen as a way to help developing countries achieve sustainable economic development. However, because the Protocol’s mechanisms were designed for compliance with emission reduction targets at the national level, this left individual governments to decide how best to involve the private sector in the process, thereby leading to fragmented markets.

Today, it has become clear that “grand bargaining” is not enough, and that there is a dire need for rigorous mechanisms both at national and international levels to effectively mobilize the private sector’s contributions in terms of cross-border capital flows and technology diffusions, especially to poor countries.

Low-carbon foreign investment: types and demand

Low-carbon foreign investment can be defined as the transfer of technologies, practices or products by TNCs to host countries, through equity (FDI) and non-equity TNC participation, such that their own and related operations and the use of their products and services generate significantly lower GHG emissions than would otherwise be the case. Low-carbon foreign investment also includes FDI undertaken to acquire or access low-carbon technologies, processes and products. There are two types of low-carbon foreign investment:

- Introduction of **low-carbon processes** that reduce GHG emissions related to how products are made. This includes upgrading of TNC operations, and those of related firms along their global value chains.

- Creation of **low-carbon products and services** that lower GHG emissions in how they are used. Low-carbon products include, for instance, electric cars, “power-saving” electronics and integrated
mass transport systems. Low-carbon services include rendering technology solutions by reengineering GHG-emitting processes in local companies.

Channelling low-carbon foreign investment into key sectors (i.e. “areas of emissions”) with high mitigation potential is the most effective way of leveraging the contribution of TNCs to lower GHG emissions. Power, industry (including manufacturing as well as oil and gas), transport, buildings, waste management, forestry and agriculture are all major GHG emitters. An assessment of projected future emissions in these sectors, combined with their mitigation potential and cost, provides policymakers with a first indication of where their efforts should be concentrated.

The power and industry sectors are the cornerstones of any global effort to reduce emissions. In both sectors, TNCs have a strong presence and are in a prime position to diffuse cleaner technologies and processes. Industry also provides equipment and services to help reduce emissions in other sectors. The transport, building and waste management sectors will each emit less than power and industry in 2030. For all three sectors, GHG emissions are to a large extent related to consumers and public use. In the transport sector, for instance, GHG emission reductions require more efficient vehicles and a change in consumer and corporate habits. In a similar vein, in the building sector, the use of improved appliances, lighting and insulation, as well as alternative power sources for heating and cooling, go a long way in reducing emissions. The waste management sector’s emissions result largely from waste landfills and wastewater, with potential mitigation largely about landfill methane recovery. The two land-related sectors, agriculture and forestry have high abatement potential; in the case of forestry one greater than its emission – due to potential afforestation and reforestation. To all these sectors, TNCs can make important contributions.

Low-carbon foreign investment is significant and its potential is huge

Low-carbon FDI is estimated to have already reached a significant level, with flows of roughly $90 billion in 2009 in three key industries alone: (a) alternative/renewable electricity generation; (b)
recycling; and (c) manufacturing of environmental technology products (such as wind turbines, solar panels and biofuels). These industries form the core of initial new low-carbon business opportunities. Over time, low-carbon investment will permeate all industries, for example as TNCs introduce processes to reduce GHG emissions. Looking beyond FDI, low-carbon foreign investment is – and will be – more significant, as it also covers non-equity forms of TNC participation such as build-operate-transfer (BOT) arrangements.

An analysis of the three industries mentioned above reveals the following trends:

- There has been a rapid increase in low-carbon FDI in recent years, though it declined in 2009 as a result of the financial crisis (fig. 7).

- Around 40 per cent of identifiable low-carbon FDI projects by value during 2003–2009 were in developing countries, including in Algeria, Argentina, Brazil, China, India, Indonesia, Morocco, Mozambique, Peru, the Philippines, South Africa, Turkey, the United Republic of Tanzania and Viet Nam.

- Established TNCs are major investors, but new players are emerging, including from the South. TNCs from other industries are also expanding into the field.

**Figure 7. FDI in three low-carbon business areas, by group of economies, 2003–2009**

![Graph showing FDI in three low-carbon business areas by group of economies, 2003–2009.](source: UNCTAD, World Investment Report 2010.)
• About 10 per cent of identifiable low-carbon FDI projects in 2003–2009 were generated by TNCs from developing and transition economies. The majority of these investments were in other developing countries.

Drivers and determinants of low-carbon foreign investment

Drivers (push factors) such as home-country policies, public opinion and shareholders’ muscle are increasingly weighing on TNCs’ decisions to invest in low-carbon activities abroad. Many of these drivers affect foreign investment in general, but a number are specific to climate change, for instance: (a) outward investment promotion measures in renewable energy for rural electrification; (b) policies that trigger the establishment of relevant technological capabilities, which are subsequently spread internationally; or (c) consumer pressure and shareholders’ demands leading to increased disclosure of climate change risks and opportunities.

Locational determinants are host country-specific factors that influence TNCs’ decisions on where to set up operations (pull factors). Tailored policy frameworks and business facilitation are essential to attract low-carbon foreign investment. In addition to general determinants of foreign investment (e.g. market size and growth, access to raw materials, different comparative advantages or access to skilled labour), there are certain variations specific to climate change: market-creating or -defining policies can foster demand for new low-carbon products and services, particularly in the power, transport, building and industry sectors – and thereby draw in market-seeking foreign investment. Similarly, low-carbon technologies in particular countries can attract the attention of strategic asset-seeking foreign investors. As with any dynamic technologies, consolidation by M&A activity may occur in the low-carbon area; investors may also seek to participate in industry or technology clusters to gain knowledge from agglomeration and related effects.

Strategies for low-carbon foreign investment: pros, cons and policy options

Developing countries are confronted with two major challenges in responding to climate change and moving towards a low-carbon economy: first, mobilization of the necessary finance and investment;
and second, generation and dissemination of the relevant technology. Both are areas in which foreign investment can make valuable contributions.

Nevertheless, developing countries need to examine the pros and cons of low-carbon foreign investment when determining whether or to what extent they should be facilitating it. When adopted, such a strategy should help improve production processes and the emergence of new technologies and industries. This can offer advantages over and above the benefits usually associated with the FDI package, such as leapfrogging to new technologies, particularly for the efficient use of energy and other inputs, as well as first-mover advantages and attendant export opportunities in key industries.

A number of possible disadvantages need to be weighed against these benefits. Among them are the crowding out of domestic companies, technological dependency, higher costs for essential goods and services, and related social consequences. These are challenges that LDCs and other structurally vulnerable countries, in particular, are ill-equipped to meet alone.

When promoting low-carbon foreign investment, policymakers need to consider the advantages and disadvantages, both in terms of economic growth on the one hand, and environmental, human health and sustainable development on the other, with a view to minimizing potential negative effects and maximizing the positive impacts. There is no “one size fits all” solution. Therefore, a policy mix in response to country-specific conditions is desirable. The following discussion is about policy options regarding investment promotion, technology dissemination, international investment agreements, corporate climate disclosure, international support and other relevant areas. Based on these considerations UNCTAD advocates a global partnership to synergize investment promotion and climate change mitigation and to galvanize low-carbon investment for sustainable growth and development. This partnership should include, pursuing clean-investment promotion strategies; enabling the dissemination of clean technology; securing IIA’s’ contribution to climate change mitigation; harmonizing corporate GHG emissions disclosure; and establishing an international low-carbon technical assistance centre to leverage expertise, including from multilateral agencies.
Strategizing national clean investment promotion

Most countries have not factored in low-carbon investment attraction into their current investment policy framework and promotion strategies, as shown by a recent UNCTAD survey of national investment promotion agencies (IPAs). One important step forward would therefore be to integrate the potential role of low-carbon foreign investment into developing countries’ Nationally Appropriate Mitigation Actions (NAMA) programmes. In particular, it would mean putting in place policies to attract foreign investment which can contribute to the reduction of carbon intensity in traditional industries. It would also imply building upon emerging business opportunities for new types of low-carbon foreign investment, such as investment in renewables, and implementing proactive efforts to promote low-carbon investment.

Creating an enabling policy framework. This includes the provision of adequate investment promotion, protection and legal security. Other supporting policies include the provision of incentives and regional integration agreements to overcome constraints of market size for low-carbon foreign investment. The emergence of new areas of low-carbon foreign investment – e.g. the production of renewable energy and associated products and technologies, fuel-efficient or alternative-fuel modes of transport and new building materials – is likely to require specific policies to complement the “traditional” elements of the policy framework.

Foreign investment into new low-carbon industries may not be competitive in the start-up phase and may therefore need government support, such as feed-in tariffs for renewable energy or public procurement. In addition, such market-creation mechanisms are likely to require revisions to the regulatory framework, including the establishment of emission standards or reporting requirements. There is a need for capacity development in developing countries to enable them to deal with these complex tasks.

Promoting low-carbon foreign investment. The promotion of low-carbon foreign investment also has an important institutional component. Governments need to identify opportunities for such investment in their countries and formulate strategies to promote it. Investor targeting, image-building, aftercare and policy advocacy are all...
key functions that national IPAs could use to this end. The latter should focus on specific economic activities when they spot a promising opportunity for developing domestic low-carbon growth poles and/or export potentials, and design a promotion package in those areas. The establishment of clean technology parks can facilitate the entry of foreign investors. IPAs can offer matchmaking services by helping low-carbon foreign investors to build networks and connect with local entrepreneurs. IPAs can also advocate national policies to strengthen a country’s attractiveness for low-carbon foreign investment.

Building an effective interface for low-carbon technology dissemination

As a vast pool of technology and know-how, TNCs can play a major role in diffusing low-carbon technologies to developing countries. Nevertheless, technology dissemination is a complex process and many developing countries face difficulties in establishing effective policies. Among the key issues to be considered are the following:

Technology targeting. A number of factors might affect host governments’ prioritization and targeting of foreign investment to boost prospects for technology dissemination. For instance, a government may identify targets for promotion efforts through an assessment of a country’s natural resources and created assets. In specific segments of industries and value chains, where the absorptive capacities of domestic companies are high but low-carbon technology and know-how are lacking, governments can target specific foreign investors in order to acquire the necessary know-how. Such approaches have been taken by countries such as Malaysia, Morocco and the Republic of Korea.

Creating a conducive framework for cross-border flows of technology. The key elements of a favourable environment for cross-border flows of low-carbon technology include availability of the requisite skills, appropriate infrastructure (e.g. some countries are setting up low-carbon special economic zones), measures to define and create markets in low-carbon products, targeted incentives (e.g. to invest in the necessary R&D or technology adaption) and a strengthened legal system. How these issues play out varies between economies; for instance, some developing countries have
the resources to bolster education and training in the necessary skills. Another issue for cross-border technology flows into host countries is intellectual property (IP) rights protection. Foreign investors in some sectors consider strong protection and enforcement a precondition for technology dissemination, but the actual effects differ from country to country. Concerns have been expressed by developing countries that an IP regime should not only support IP protection and enforcement, but also guarantee greater access to appropriate technologies.

**Promoting transmission of technology through linkages.** Domestic companies’ acquisition of technology from TNCs depends on the type, scale and quality of the interface (for instance, joint ventures or affiliate-supplier linkages) between the two. One option to foster linkages is to promote the establishment of local technological and industrial clusters. With the participation of both domestic firms and foreign affiliates, these clusters can help enhance the exchange of knowledge and manpower and the establishment of joint ventures between local and international companies.

**Boosting the absorptive capacities of domestic enterprises.** Host developing countries should put in place strategies to develop domestic capacities to absorb and adapt technology and know-how. In this, government-driven research and development in “cutting-edge green” technologies can play an important role. There is scope for the establishment of regional technology synergy centres focusing on low-carbon technologies for developing countries as well as the industrial and other capacities needed to put this knowledge to work. Promoting technology dissemination may also require strengthening of the financial and entrepreneurial capacities of local firms. In this context, consideration should be given to the establishment of “green development banks”.

**Minimizing the negative effects of low-carbon foreign investment**

Effective industrial and competition policies are key to tackling the negative effects of low-carbon foreign investment, such as crowding out and attendant dependency on foreign low-carbon technology suppliers. Industrial policies can help affected domestic companies
to improve and upgrade; an effective competition policy framework can control the emergence of monopolies and prevent the abuse of dominant market positions.

Social policies can also help to cushion employment impacts and other social consequences. For instance, re-skilling measures can help workers to adjust to new professional requirements or can facilitate their transition to emerging industries. For all this, poor countries will require assistance from development partners in the framework of a renewed global partnership for sustainable development.

**Synergizing international investment agreements and climate change policies**

Attention needs to be given to the dual-edged nature of IIAs. On the one hand, by committing internationally to a stable and predictable investment policy environment and providing investment protection, IIAs can contribute to increasing a country’s attractiveness for low-carbon foreign investment. On the other hand, IIAs can possibly constrain the host country’s regulatory powers with respect to measures aiming to facilitate a transition to a low-carbon economy. Relevant awards by international arbitration tribunals suggest that IIA provisions pertaining to fair and equitable treatment and minimum standards of treatment, expropriation, and umbrella clauses aimed at stabilizing the legal framework for foreign investors merit particular attention.

Numerous policy options exist to synergize the interaction between countries’ climate change and international investment policies, with a view to fostering a climate-friendly interpretation of IIAs and harnessing the potential of IIAs to ensure climate change-friendly effects. This includes novel approaches in future IIAs, such as strengthening IIAs’ promotion provisions with respect to low-carbon foreign investment, and redrafting and clarifying those IIA provisions that might lead to conflict with climate change-related policy measures. Policymakers may also wish to consider complementary, broader approaches. A multilateral declaration, clarifying that IIA parties are not prevented from adopting climate change-related measures enacted in good faith, could help enhance coherence between the IIA and the climate change regimes.
Dealing with carbon leakage

The potential relocation of carbon-intensive production from highly regulated places to countries with less stringent or no regulation on emissions has raised concerns. There are fears that this “carbon leakage” – due to free riding – impedes global emission reduction efforts, and that such relocations of production may result in a loss of investment-related benefits (e.g. tax revenues and employment) in the home country.

A debate has begun on whether to introduce border adjustment measures (e.g. tariffs) to deal with the issue of carbon leakage. There are technical difficulties when it comes to assessing the carbon intensity of individual imported goods, and there are doubts as to whether different types of border adjustment policies would be consistent with World Trade Organization (WTO) rules. In addition, caution is warranted for countries to guard against possible protectionism affecting efficiency-seeking and export-oriented outward investment under the pretext of such carbon-related policy measures.

The extent of carbon leakage is difficult to quantify. Furthermore, due to different business-as-usual scenarios between countries, a new investment facility that is considered carbon-intensive in one country could be regarded as low-carbon in another. For poor countries in dire need of expanding their productive capacities, such foreign investment could potentially generate large development gains due to the tangible and intangible assets associated with foreign investment. In the long run, however, it is in the interest of all countries to move towards an energy- and input-efficient low-carbon economy.

Instead of addressing the issue of carbon leakage at the border, it could also be addressed at its source. This would involve working through corporate governance mechanisms, such as encouraging improved environmental reporting and monitoring. Most notably, applying consistent emission policies across borders – including in host countries with laxer regulation – might generate economic and reputational benefits for TNCs. Regarding the economic benefits, consistency throughout a company’s integrated production system is not only in line with the logic of the value chain (thereby facilitating the implementation of corporate carbon policies), it can also help reduce
production, monitoring and other costs. With respect to reputational benefits, such consistency in TNC action across jurisdictions would help brand the company as a “good corporate citizen”. In this context, improved climate reporting, particularly when undertaken in a harmonized and verifiable manner, can help ensure that a company’s reputation is based on solid ground. Further improving transparency in the marketplace facilitates consumers’ choices.

**Harmonizing corporate GHG emissions disclosure**

A reliable internationally harmonized approach to measuring and reporting corporate climate change-related emissions is vital for the effective implementation and assessment of climate change policies (such as “cap and trade” schemes and carbon taxes), the internalization of climate risk into capital markets, and the monitoring of GHG emissions and clean technology diffusion throughout TNCs’ value chains. Climate-related management and reporting are common among large TNCs, but the information being reported lacks comparability and usefulness, and information on emissions by foreign affiliates and by value chains is often missing. Meeting the long-standing need for a single global GHG reporting standard requires a coordinated global response.

Unifying the work of regulatory bodies, standard-setters and multi-stakeholder initiatives can strengthen and expedite efforts to create a single high-quality global standard for climate disclosure. The United Nations can facilitate this process by offering an established international forum: the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR). Policymakers can demonstrate leadership on this issue by contributing to international efforts to harmonize climate disclosure, and by mainstreaming best practices in climate disclosure via existing corporate governance regulatory mechanisms (such as stock-listing requirements) and analyst tools (such as indexes).

**Supporting developing countries**

In their efforts to promote low-carbon foreign investment and harness TNCs’ technological potential, developing countries need assistance. *Home-country* measures can support outward low-carbon
foreign investment. For example, national investment guarantee agencies could “reward” low-carbon investors by granting them more favourable terms, for instance in the form of a reduced fee. Another means might be credit risk guarantees for investments into developing countries. It would also be helpful if developed countries would increase their financial and technological support for low-carbon growth programmes in developing countries. The example of China and the EU, which have established a proactive and pragmatic climate change partnership with a strong focus on technology cooperation and the engagement of the business community, should be replicated.

*International financial institutions* (such as the World Bank Group and various regional development banks) are actively engaged in supporting the move towards a low-carbon economy in developing countries. Their engagement should be geared towards furthering partnership approaches between the public and private sectors to help developing countries combat climate change, including by leveraging private engagement in high-risk areas without directly subsidizing TNC activities.

Efforts should be made to further enhance international technical assistance for low-carbon growth in developing countries through cross-border investment and technology flows. An international low-carbon technical assistance centre (L-TAC) could be established to support developing countries, especially LDCs, in formulating and implementing national climate change mitigation strategies and action plans, including NAMA programmes. The centre would do so by leveraging the requisite expertise via existing and novel channels, including multilateral agencies. Such a centre could also provide capacity- and institution-building in the promotion of low-carbon investment and technology dissemination.
INVESTMENT FOR DEVELOPMENT: CHALLENGES AHEAD

Over the last twenty years, TNCs and their international operations have evolved in scale and form, resulting in changes to their strategies and structure which are today shaping existing and emerging markets and industries. Among other things, the integrated international production system of TNCs of the past has been evolving towards an integrated international network in which TNCs increasingly coordinate activities between independent or loosely dependent entities, for instance through outsourcing and the use of original equipment manufacturers. At the same time, TNCs are much more involved in non-equity forms of activity, such as build-own-operate-transfer arrangements in infrastructure projects, than in the past. In addition, along with TNCs’ exponential expansion worldwide has come the rise of new players and investors, including developing-country TNCs, state-owned TNCs, SWFs and private equity funds. This new TNC universe has profound implications for the policies of both home and host countries and at both national and international levels.

Partly for this reason, the pendulum has recently been swinging towards a more balanced approach to the rights and obligations between investors and the State, with distinctive changes in the nature of investment policymaking. Particularly in light of the current financial and economic crisis, there have been simultaneous moves to both liberalize investment regimes and promote foreign investment in response to intensified competition for FDI on the one hand, and to regulate FDI in pursuit of public policy objectives on the other. This has resulted in a dichotomy in policy directions, which contrasts with the clearer trends of the 1950s–1970s (which focused on state-led growth) and the 1980s–early 2000s (which focused on market-led growth). With thinking about the rights and obligations of the State and the investor in flux, striking the proper balance between liberalization and regulation becomes a challenging task. Ensuring coherence between international and domestic investment policies and investment and other policies (economic, social and environmental) is essential. A good example is the interaction between investment and industrial policies which require a joined-up approach to foster linkages and spillovers (including...
the dissemination of technology) arising from TNC operations in host countries.

The challenge for policymakers is to fully comprehend the depth and complexity of the TNC universe and its new interface with the state and other development stakeholders. Meeting this challenge requires that the tripartite investment relationship in terms of rights and obligations between home and host countries and foreign investors be reconfigured, to better harness the contribution of TNCs for development. In particular, the policy framework has to enhance critical interfaces between investment and development, such as those between foreign investment and poverty, and national development objectives. Indeed, TNCs have a role to play; and, above all, the world needs a sound international investment regime that promotes sustainable development for all.

The new TNC universe, along with the emerging investment policy setting, calls for a new investment-development paradigm.

Geneva, June 2010  
Supachai Panitchpakdi  
Secretary-General of the UNCTAD
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