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FDI, the global crisis and sustainable recovery

Ucheora Onwuamaegbu and Karl P. Sauvant *

The western financial and economic crisis that began in 2008 was the worst for 70 years – by far more severe than, for example, the Asian financial crisis in the 1990s and the post-September 11, 2001 crisis. Among its many effects has been a significant downturn in global foreign direct investment (FDI), a phenomenon whose impact has been different in developing and developed economies. Since economic growth is the single most important FDI determinant for attracting investment, the global economic slowdown, accentuated by the crisis, rendered key markets less attractive for foreign investors – and hence depressed FDI flows. This impact was aggravated by severe restrictions on the ability of firms to invest abroad.

In view of the widely acknowledged role of FDI in economic development, the Fourth Columbia International Investment Conference gathered world-renowned experts to examine the causes of the crises and, in particular, to discuss issues related to a sustainable recovery from the crisis. The Conference, organized by the Vale Columbia Center on Sustainable International Investment, the University of St. Gallen, and the Ministry of Foreign Affairs of Finland, with support from Vale, attracted 230 participants, from over 31 countries, including leading economists, representatives of governments and intergovernmental organizations, legal practitioners, and development experts. It specifically addressed how the crisis is affecting FDI (including the impact on flows, new players, changing patterns of agricultural sector FDI), the changing business environment for FDI (including the effect of the crisis on social conditions, corporate social responsibility and resource nationalism), and public policy opportunities for a sustainable recovery and sustainable development (including public-private partnerships, a global bankruptcy law and a sustainable investment regime).

The Conference offered a platform for a better understanding of the views and concerns of the principal players on the economic, social and environmental implications of the global economic crisis in the FDI field,

* Mr Onwuamaegbu was Rapporteur of the Fourth Columbia International Investment Conference, 5-6 November 2009. Dr Sauvant is Executive Director of the Vale Columbia Center on Sustainable International Investment.

and for exploring the way forward. It, thus, presented an opportunity to take stock as the impact of the crisis became clearer and the need to ensure a sustainable recovery, in light of worsening environmental conditions and insufficient attention to development needs in poor countries, became more apparent.

This introduction sets out the highlights of the presentations and discussions. It is followed by the publication of a selection of the papers that were presented at the conference.

The dimensions of the global crisis and challenges for sustainable FDI

Jeffery D. Sachs,[1] in his keynote speech titled "The dimensions of the global crisis and challenges for sustainable FDI", addressed the origins of the downturn and its manifestations, such as high and rising unemployment in both advanced and developing economies, from the Democratic Republic of Congo, where mines were closing, to the United States, where one person in nine was on food stamps.[2]

As causes of the problem, he identified misguided monetary policy, combined with deregulation of the derivatives market; the fact that the credit default swap market was allowed to grow from zero to $62 trillion with no regulation – by design; and that zero interest rates and unregulated credit default swap existed – partly due to lobbying in the United States Congress. He stressed the need for government to reassert and interpose itself, especially in regulating the markets.

Sachs noted, as a feature of the current downturn, a decoupling in the world economy. In effect, the crisis has had a differentiated impact on different regions of the world: Asia experienced a quicker recovery, because the region is now a free-standing economy and a major creditor of the United States and parts of Europe. This result, he noted, is largely attributable to stimulus packages in China and India, which helped the quick recovery in those countries. Sachs further observed

[1] Director, the Earth Institute at Columbia University; Quetelet Professor of Sustainable Development, Columbia University.

[2] The keynote speech was preceded by welcoming comments by Lee C. Bollinger, President, Columbia University. Bollinger, *inter alia*, stressed the importance of the free flow of information as a way of facilitating world order by projecting the experience of the past century onto the world stage, in order to maintain sustainable FDI.

that, with a few exceptions, most of China is experiencing massive growth, and that the same goes for other parts of Asia. Although China is relatively poor, it has a high capacity to absorb technology. According to Sachs, the risks to watch out for in Asia are crises of politics and/or environment. Otherwise, with exporters able to shift from the United States market to exporting to Asia, by 2025–2030, Asia stands a good chance of becoming the centre of the world economy, especially with regard to the size of its population.

According to Sachs, a potential threat to the rise in the world economy is worldwide environmental crisis, which is deepening. In particular, climate shocks, food and water crises, deforestation, habitat loss, and species extinction are getting worse. Similarly, health conditions that have emerged in recent history, such as the AIDS, SARS and H1N1 viruses, are all in some respect attributable to environmental factors. Indeed, the world has reached a level of human impact on the environment that is unsustainable (China's growth alone is having a significant environmental impact), and markets alone do not ensure the sustainability of investment. The approach of governments, including that of the United States, should shift from "scrambling" to "conserving".

Sachs considered that the technological capacity and potential to resolve crises exist. However, the framework for that capacity to assert itself does not yet exist. Highlighting the critical role of the United States in creating most of the post-Second World War international institutions, including the United Nations, Sachs noted that the United States' dominant position in the world is waning because of factors including the following: the dispersion of power and technology globally since 1980; the rise of Asia; problems of the United States' political system (including the dominance of the lobby system, which impedes necessary corrective government actions); and the lack of coherent climate, health care and fiscal policies, although the Obama administration has taken action in this respect.

A new form of global governance is, therefore, needed to replace the hegemony model, which is now over, and in any event not feasible in a world characterized by global literacy. Possible replacement models include the G20 model, which, although it has not succeeded before, could well do so. This model brings together four international organizations and a number of governments, and represents about 4 billion people. The discussions of the G-20 Group are at a very high level, and it could direct the United Nations to take actions in treaty format. There is, however, no institutional framework, as yet, for the work of the Group.

Another possible model is the Regional Integration model as it currently exists among member States of the European Union. This model is being replicated in other regions, as in Africa, where the Africa Union is, commendably, seeking to copy the European Union model. East Asia could also find a way institutionally to create regional governance; and ASEAN plus the Republic of Korea, China and Japan will be a remarkable force, which will take shape over time. Yet another possible model is the Local Governance model, which, in the United States, for example, would entail more devolution of power from the Federal to State Governments. Such a model is particularly feasible in a globalized world economy, in which it is now easier for local governments to conduct business with the entire world. A final possible solution is one that brings together, and harnesses, the capacities of industry, civil society and public/private partnerships, where industry and not government takes the lead. Indeed, companies have the capacity, but not the incentive, to solve global problems. Therefore, a normative environment in which strong roles are played by civil society and government regulation might help achieve the desired result.

How does the global crisis affect FDI?[3]

Gary Clyde Hufbauer,[4] in a presentation titled "The impact of the financial crisis and recession on global FDI flows",[5] assessed the overall impact of the crisis on the quantity and patterns of FDI flows by region, sector and mode of entry (especially of mergers and acquisitions (M&As)), including a discussion of the staying power of FDI in times of crisis, and some policy implications arising from the findings. Noting that most industry-level FDI flows, regardless of sector, have declined and that, generally, companies (even amongst resilient industries,

[3] This was the title of a session of the conference which was chaired by Katharina Pistor, Professor, Columbia Law School.

[4] Reginald Jones Senior Fellow, Peterson Institute for International Economics.

[5] The presentation was based on a paper co-authored with Lauge Skovgaard Poulsen, Ph.D. candidate, London School of Economics.

such as health care, biotech and renewable energy) were reducing their international activities, he concluded that there are reasons to be sceptical about the medium-term prospects for FDI recovery after the current crisis. Further, he predicted that FDI inflows to emerging markets would recover faster than developed economies, partly due to the increase in South-South FDI flows. He counselled that, by keeping the investment climate open and improving the many dimensions of good governance, governments would be able to facilitate and retain foreign investment, which would be critical for recovery.

In his presentation titled "The impact of the crisis on new players: are they ready to pounce?", Ravi Ramamurti[6] identified the new players in FDI as sovereign wealth funds (SWFs), private equity (PE) funds and emerging market TNCs, examining their respective roles in FDI and addressing the question as to how they have fared during the crisis − in particular, whether they are capable of dislodging Western transnational corporations (TNCs) as a result of the crisis. Although SWFs are not new on the scene, they have been more active in FDI during the crisis, yet their future in FDI seems uncertain. PE funds are also not new, but their contribution to FDI remains small and may not be sustainable. SWFs remain marginal players and PE funds are volatile in their operations. According to Ramamurti, of the three players, only emerging market TNCs are both significant enough and capable of a sustained contribution to FDI flows. Indeed, they have been steadily increasing in importance, with their stock growing by six times between 1990 and 2001 and by three times between 2000 and 2008, to a figure of approximately $2.6 trillion. The advantages enjoyed by emerging market TNCs include a deep understanding of local customers; a capacity for ultra low-cost value chain operations; know-how for operating in economies with weak institutions; and late-mover advantage in mid-tech industries. Indeed, some are already leading players in certain fields, such as Chinese companies in the solar energy sector. On the downside, their activities are frequently implicated in the depletion of natural resources. As a result, traditional TNCs will have to compete effectively with emerging market TNCs if they are to survive.

[6] CBA Distinguished Professor of International Business; Director, Center for Emerging Markets, Northeastern University.

In a presentation titled "Sustainable FDI in agriculture: the challenges ahead", James Zhan[7] highlighted the key emerging trends in activities of TNCs in agriculture (including the evolving pattern of agriculture FDI and contract farming) and the related development challenges. Discussing the policy implications that arise from these trends for developing countries and the international efforts underway to promote responsible investment in agriculture, Zhan noted that agriculture is insignificant in terms of percentage share of total FDI, and that Western TNCs involved in agriculture are more focused on cash crops, while those from developing countries tend to be more involved in food production. He identified as an overall challenge the need to ensure investment in sustainable agriculture, especially as contract farming is a good way for TNCs to enjoy a regular income. In particular, the challenges are how to ensure, by way of safeguards, that TNCs do not jeopardize food security, since they focus more on cash crops; and how to monitor land acquisitions, especially, since TNCs are acquiring huge expanses of land in developing countries and these activities have an environmental impact. Indeed, agriculture is responsible for a substantial share of carbon emissions.

In the ensuing discussion, Jorge Héctor Forteza[8] noted the absence of scruples on the part of some resource-based TNCs. While companies from Brazil and India are doing well, few are playing in higher value-added fields, although, admittedly, some bring in innovation. These companies have succeeded by developing strategies that are suitable for their own environments, but this is not always a good thing, since the implication is that they are succeeding simply due to their ability to deal with peculiar systems. In effect, they are better at operating in weak regulatory environments, and such operating models do not necessarily travel well. Therefore, with the exception of a few companies in Brazil, China and India, the challenge is to find emerging market TNCs that will operate effectively at the higher end of global operations. According to Forteza, it could be another 20 years or so before emerging market TNCs are able to compete effectively globally.

[7] Director, Division on Investment and Enterprise Development, UNCTAD.

[8] Professor of Strategy and Competitiveness, University of San Andrés, Buenos Aires.

Rainer Geiger,[9] also commenting on the new players in the world FDI market, noted that, while some are very complex operations, SWFs in general could play an important role in future FDI. While the role of TNCs in sustainable FDI, on the other hand, would seem dubious, performance requirements for such companies might be a good thing, especially if they have received government assistance package. Overall, the current financial crisis presents a major opportunity for the building of a comprehensive governance system for FDI.

United States recovery, global sustainable development and FDI

In the luncheon address titled "U.S. recovery, global sustainable development and FDI", Joseph E. Stiglitz[10] noted that the current crisis was likely to change the global economic landscape for years to come. The indicators include the fact that the ordinary rules of capitalism have been suspended with the introduction of massive bail-outs by the Government of the United States. The concept of banks that are too big to fail – introduced by the Bush administration and upheld by the Obama administration − is a new rule that never previously applied in capitalism. These "too big to fail" companies can enter into risky businesses, knowing that, if things go wrong, the Government will bail them out. This has unbalanced the playing field, because capital will keep flowing to the big banks, which now have "government insurance". Subsidies are less fair than tariffs as they amount to a trade distortion favouring the rich countries. Every country can impose tariffs, but only the very rich can provide subsidies. In light of all this, Stiglitz questioned how any developing country investor could compete with the Government of the United States, which explicitly stands behind the United States banks.

Part of the solution to the current problems will come from FDI, e.g. from China. China's investment in Africa exceeds that of the World Bank and the African Development Bank combined. China will take a loss on its dollar holdings if it lets its currency appreciate. Depreciation of the dollar is therefore unpopular with China. Stiglitz supported the

[9] Attorney-at-law, Senior Advisor, Arab Centre for the Development of the Rule of Law and Integrity.

[10] Nobel Laureate and University Professor, Columbia University.

call for a global reserve currency, but noted that the Government of the United States is not enthusiastic about this idea, because of its huge deficits. The United States is currently able to borrow at zero interest rates, and the worry is that this ability would be diminished with a movement to a global currency. This is wrong because that ability is already diminished. In effect, a global reserve currency system would be good for the world, but will present problems for the United States in financing its deficits.

According to Stiglitz, financial markets are an important aspect of FDI as they provide the necessary financing for investments. However, confidence in United States banks' abilities regarding risk management has been undermined by the crisis. This will likely lead to the development, in Asia, of its own financial market. Indeed, one lesson from Iceland's bank failure is that a single market system cannot work without regulation.

The crisis and the changing business environment for FDI[11]

In speaking about "Managing at a time of deep crisis", John D. Daniels[12] addressed three issues: the position of FDI in the global economic recovery; the methods for harnessing the capabilities of TNCs with regard to environmental sustainability; and changes occurring as a result of the crisis that might affect managerial behaviour in the future, particularly as it relates to FDI activity. Concerning the effects of the crisis, he noted that the current situation has increased the risk of a return of nationalization and expropriation, as it has provided an easy excuse for dictators, for instance, to expropriate if they wish to do so. In addition, the recent increase in transport costs has reversed offshore activities, not only because of the actual costs but also due to the uncertainty of the costs resulting from their volatility. Another effect of the economic crisis is that companies have been forced to downsize (especially abroad) in order to protect their core locations, which are their home markets. He concluded that, while TNCs have played a role in the economic and environmental crisis currently facing the world,

[11] This was the title of a session of the conference, which was chaired by Richard N. Gardner, Professor of Law and International Organization, Columbia Law School.

[12] Samuel N. Friedland Chair, University of Miami.

others – domestic firms, governments that do not take actions – are equally or even more culpable. The crisis will however bring about changes in the way TNCs and countries operate, which changes are likely to subsist long after the crisis is over.

In his presentation: "Enhancing the contribution of FDI to development: a new agenda for the corporate social responsibility community", Theodore H. Moran[13] analysed how corporate social responsibility (CSR) programmes have been affected by the crisis and, most importantly, what the role for CSR would be in achieving a sustainable recovery. He proposed a new CSR agenda that focuses not only on direct philanthropy, but also on socially responsible ingredients that operations of foreign investors could inject into the system. This is all the more effective when the operations of TNCs are run in an open, competitive and well-structured manner.

Daniel M. Price,[14] in "The rise of FDI protectionism", assessed the impact of the crisis on the attitude towards inward and outward FDI and, in particular, what policy and regulatory actions had been taken. He examined the question of how to deal with the rise of FDI protectionism, and expounded on the effect of various bail-outs of national industries and firms and the possible international investment law implications of these bail-outs. In particular, Price identified new frontiers in FDI protectionism, led by those states in the developing world that traditionally restrict investors, but by developed countries. These frontiers are in financial regulatory reform; domestic stimulus and crisis response; climate change; and national security and the scramble for resources.

On financial regulatory reform (in Europe and the United States), for example, he noted that the Government of the United Kingdom has proposed liquidity requirement for its banks, albeit for their United Kingdom holdings only and not globally. Steps have also been taken by the Swiss authorities in this direction. Price argued that these new regulatory requirements are turning back the clock, both in Europe and

[13] Marcus Wallenberg Chair in International Business and Finance, Georgetown University School of Foreign Service; Non-Resident Senior Fellow, Peterson Institute of International Economics.

[14] Senior Partner for Global Issues, Sidley Austin LLP; former Assistant to the President and Deputy National Security Advisor for International Economic Affairs in the Bush administration.

the United States. On domestic stimulus, he noted that some of these programmes discourage cross-border investment. National security concerns and their impact on FDI flows are becoming more important.

Price was followed by a presentation on "Multinational enterprise strategy after the crisis: responding to new challenges", by Alan M. Rugman.[15] Rugman discussed some of the implications of the crisis for the strategy of TNCs. Some of these relate to the increased emphasis that was placed on sustainable development, including as regards the use of energy and climate change. Others had to do with the use of subsidies, the rise of FDI protectionism and the promotion of national champions. Rugman noted that strategies of TNCs are geared towards creating firm-specific advantages. Home government policies, such as subsidies, on the other hand, reinforce country-specific advantages that do not necessarily coincide with firm-specific, micro-level decisions of firms. In any event, while Western TNCs benefit from the international diversification of their operations, emerging market firms are viewed by their governments as national champions and are more likely to be beneficiaries of advantageous country-specific policies. FDI from developing countries is driven more by country-level, rather than firm-level, factors. This explains the much-touted resilience of emerging market TNCs in the face of the crisis. It also means that the crisis has had different implications for developed country TNCs and emerging market TNCs, so their approaches and responses will of necessity be different.

Climate change, FDI and the Copenhagen Summit

In his dinner address, titled "Climate change, FDI and the Copenhagen Summit", Robert Orr[16] noted that the crisis is hitting the "near poor" of the world the hardest, turning them to the "new poor". The social impact of the crisis is therefore of concern, especially if the global response does not include vulnerable members of the society. The Copenhagen climate negotiations, which he described as the most complex in the history of mankind, would – if successful – unlock capital globally. Global economic recovery would in any event benefit from a

[15] Professor of International Business and Director of Research, School of Management, Henley Business School, University of Reading.

[16] Assistant Secretary-General, Strategic Planning Unit, Executive Office of the Secretary-General, United Nations.

jolt from a climate change deal. He hoped that a macro framework agreement would emerge from the Copenhagen negotiations from which a legally binding document could then be negotiated ultimately to produce a treaty. The main elements of a macro deal would involve all countries; include mid-term targets, i.e., by 2020 for developed countries; and mitigation commitments by all for between 25 and 40% reduction in carbon emissions by 2020. Finance and technology are both important to aid adaptation and mitigation of countries to the changing global climate.

Public policy for FDI and sustainable recovery[17]

The presentation by Jennifer Clift,[18] titled "Do we need an international bankruptcy law for TNCs?", discussed the desirability and feasibility of developing an international bankruptcy law and its importance to sustainable recovery and development against the background of growing numbers of insolvencies with international, cross-border dimensions and the work currently being undertaken on enterprise groups and cross-border insolvency. Clift noted that a lot has been achieved in the area of insolvency law reform since the Asian crisis, including removal of the stigma attached to insolvency as part of the normal business cycle. This is particularly important since an insolvency regime can facilitate economic recovery. She observed that the present international norm is to move away from an effective liquidation regime towards greater emphasis on the restructuring of debts. There is still a role for liquidation, but mechanisms that will achieve the purpose of insolvency, such as the sale of a business as a going concern, would better achieve the aim of insolvency.

Addressing the question of whether an international regime is needed for dealing with insolvency generally, Clift observed that the laws of individual states are different and produce many insolvency regimes, resulting in the fragmentation of large businesses operating across borders, and that such a situation would only be acceptable if liquidation were the object. Otherwise, an international regime is crucial, especially for dealing with large companies made up of different

[17] This was the title of a session of the conference which was chaired by José E. Alvarez, Professor of Law, New York University Law School; Former President, American Society of International Law.

[18] Senior Legal Officer, United Nations Conference on International Trade Law.

smaller affiliates. The options for dealing with an international regime include a single law, with each country dealing with companies within its territory. This is close to what is in place now, but it has its defects. Alternatively, UNCITRAL has come up with the middle-way solution of a Model Law, which so far has been adopted by 18 states of the 192 members of UNCITRAL. Although the world is moving closer to greater cooperation, resolution of this issue remains elusive. Regionalization will help reduce the number of jurisdictions to deal with, but problems would still persist with inter-regional dealings.

In a presentation titled "Public-private partnerships and FDI", Geoffrey Hamilton[19] discussed how FDI can contribute to a sustainable recovery from the current crisis, (particularly through public private partnerships (PPPs), including a discussion of long-term financing, creating international support for a green recovery, the development and role of infrastructure banks, and ensuring the availability of finance for sustainable FDI through export-credit agencies, risk insurance agencies, the IFC, and similar institutions. He called for the establishment of a United Nations PPP centre for PPP excellence, which would address challenges and barriers to PPP FDI in emerging markets, including the dearth of bankable projects.

In "Elements of an international investment regime that encourages sustainable international investment", Gus van Harten[20] discussed how the international investment law and policy regime could be moved in a direction that made it more supportive of sustainable development – including through treaties, voluntary initiatives, contract negotiation, and the like. Van Harten noted that, to encourage sustainable development, the international investment regime must ensure that there is sufficient policy space and regulatory flexibility for governments, while reassuring investors that they would not be targeted *ex post facto*. These twin aims are not met by the current regime of bilateral investment treaties and other investment treaties. There should be a focus on first fixing domestic policy frameworks before looking to the international regime. This would attract FDI, as investors would normally look at domestic regimes before international ones.

[19] Chief, Cooperation and Partnerships Section, United Nations Economic Commission for Europe, Economic Cooperation and Integration Division.

[20] Associate Professor, Osgoode Hall Law School, York University.

Van Harten criticized the use of arbitration instead of courts to deal with "important" issues, noting that arbitration lacks the openness and independence available in judicial proceedings, and the absence of institutional judicial safeguards in arbitration, observing furthermore that the main advantages to investors of the availability of arbitration are moral persuasion and deterrence, and noted that most investors would otherwise never be in a position where it made sense for them to go to arbitration rather than the courts. The reasons for this include the cost of arbitration proceedings; the fact that arbitration sours the relationship between the investor and the host government; the danger of costs award against the investor, making it difficult, if not impossible, for them to continue afterwards; the fact that many governments use delaying tactics in their proceedings, which could be frustrating for, and possibly eventually exhaust the investor in the proceeding; as well as the fact that, as happens in commercial arbitration, there are recent indications that governments may resist or refuse to pay arbitral awards obtained against them by investors.

Regarding ways to improve the system, van Harten suggested the introduction of institutional safeguards of judicial independence, which he considered to be better in courts than in arbitration; the introduction of measures to make the system more accessible to small players; the imposition of a duty on investors to exhaust local remedies before proceeding to arbitration; a change to the mechanism of using damages as primary remedy in arbitration; and rendering ineligible for compensation general measures that are not discriminatory.

In a presentation titled "Investor state arbitration and the financial crisis: A perspective from ICSID", Meg Kinnear[21] provided an institutional perspective from ICSID's experience with financial crisis-related disputes. It is possible that the current crisis will result in a further increase in the number of cases brought to ICSID, which have been on the rise in recent years in any event. Issues that may become more relevant in this context include considerations of the rights of host countries to take certain actions (e.g., the question of essential security interests) and considerations of sustainable development in dispute settlement. It remains to be seen whether the crisis will influence the decisions of governments to strengthen existing investor–state dispute

[21] Secretary-General, International Centre for Settlement of Investment Disputes.

settlement mechanisms or, on the contrary, weaken them. Either way, new treaties would have to be worded very precisely in order to deal with emerging issues. On its part, ICSID has been introducing various initiatives better to serve its users, and is therefore prepared to deal with any surge in case load that may result from the current crisis. These steps would, in turn, ensure that the Centre remains a leader among arbitration institutions.

In the ensuing discussions, the panel and conference participants discussed various points arising from the above presentations.[22] Kevin P. Gallagher called for the introduction of policies by which FDI helps with sustainability, and not crowding out domestic investment. Crowding out results in slower economic recovery. Hence, in previous crises, recovery was quick in Asia, but not Latin America, where FDI substituted local investment in the wake of the financial crisis. Howard Mann noted that sustainable development requires investment; that investments made now will determine whether the planet is sustainable environmentally in 30 years – in other words, the results of investments today will be felt in 30 years; and that there is no conflict between the interests of the business community and the sustainability of development.

Jose Alvarez questioned the conclusion by Clift that the lack of adequate insolvency law hinders FDI. He wondered to what extent the emphasis in insolvency situations should be to keep a business as a growing concern, as opposed to liquidating it. Regarding the court model for appointment of arbitrators for investor–state disputes, he noted that even the International Court of Justice (ICJ) has a politicized method of selecting judges and does not have an enforceable code of ethics. He noted that the issue should not simply be the creation of policy space, but rather determining what should go into the space. This will require a reconsideration of existing BITs, one treaty at a time, ultimately resulting in the creation of new types of BITs, with a focus not so much on where to litigate, but what to litigate.

FDI and African economic development

[22] The lead discussants were Kevin P. Gallagher, Associate Professor, Department of International Relations, Boston University; and Maya Steinitz, Associate-in-Law, Columbia Law School

In a luncheon address titled "FDI and African economic development", Kaire Mbuende, Ambassador of Namibia to the United Nations, questioned whether FDI has really been good for Africa in terms of its impact on local economies. He noted that investments would go where the returns are likely to be highest, regardless of any incentives available or the lack thereof. He stressed the need for policy to ensure that the result of FDI is beneficial to the host country, noting that unless there is a shift in character of FDI, from extractive industries towards technological transfer and management to develop African human resources, the beneficial impact of FDI will continue to be minimal.

FDI, the global crisis and sustainable recovery: the way forward

In addressing the topic "FDI, the global crisis and sustainable recovery: the way forward", a concluding roundtable panel consisting of Karl P. Sauvant as Chairperson, as well as Karin Lissakers,[23] Daniel M. Price, Jeffrey D. Sachs, and Manfred Schekulin,[24] discussed possible lessons from this crisis for the future of FDI and government-business relations − in particular, how the crisis could be used as an opportunity to enable FDI to play a role in a sustainable recovery.

Manfred Schekulin noted that, among the lessons to be drawn from the crisis, is that better regulation by governments is required. Similarly, steps should be taken to ensure that the true identity of investors is known to regulators in order for regulation to be effective. For instance, regulators need to be made aware when sovereign investors are investing through private equity funds. Indeed, increased participation of the EU in the regulation of FDI is desirable. With the Lisbon Treaty now signed, the EU has FDI treaty-negotiating competence, and this should make the process easier. Schekulin further proposed that any new regime for FDI should start from the concept of property protection; look at the broader issues that link it to society; consider denationalization/ privatization; and deal with dispute resolution, including transparency.

[23] Director, Revenue Watch Institute; former United States Executive Director on the Board of the International Monetary Fund.

[24] Chairperson, OECD Investment Committee.

Dan Price observed that well-regulated markets deliver benefits; that the world needs global rules in this respect and is gradually getting close to this goal with more BITs coming into effect, all with concordant provisions; and that the G20 is also playing a useful role in global regulation. Price further noted that, although there are lots of existing, although underutilized, tools for regulating FDI, a multilateral agreement on investment would be desirable, but its negotiation would be difficult.

Karin Lissaker propounded that "transparency" is one principle that should be embodied in any global regime, since common rules and standards are attained faster with transparency. Therefore, public information is crucial to know who is doing what.

Various other points, suggestions and recommendations were also made in the course of the concluding roundtable:

- Making OECD Guidelines binding is a challenge.
- Many of the economic development goals of governments should be put to tender.
- The most sustainable sort of investment is that which marries the core purpose of the investor with those of governments.
- The world ought to be thinking of how to build legitimate economic development goals into contracts.
- Most FDI is not done in the context of a contract, but rather under a general regulatory and treaty regime. With regard to contracts, it is best to set everything in law and then have an open bid auction, rather than negotiate individual contracts, especially since large investors will always have better professional assistance from lawyers, etc., when negotiating individual contracts. In any event, government contracts should be negotiated publicly, and their terms should also be public. Although it is often governments that insist that contracts be confidential, the IFC is moving towards insisting that the contracts that the IFC is involved in be made public. Guidance is also available from the Natural Resources Charter (naturalresourcescharter.org), which deals with everything concerning contract negotiation.

Conclusion

The conference presented an opportunity for a wide-ranging analysis of the causes and consequences of the crisis, especially as they relate to FDI. Its timing ensured that the resulting proposals were not facilitated by the benefit of hindsight, but informed only by contemporaneous experience, which not infrequently is a true test of analytical rigour. Indeed, there were various proposals from the conference, ranging from a call for a new reserve currency, to one for a new CSR agenda that focuses not only on direct philanthropy but also on socially responsible ingredients that FDI could inject into their activities. While a number of the ideas were new, some – equally relevant – were reiterations or modifications of existing themes.

Ultimately, as the world emerges from the current crisis, future analysis would be beneficial, not only to assess the accuracy of the predictions and efficacy of those of the proposals that would have been implemented, but also to ensure a continued dialogue that would potentially help in the understanding and handling of future crises and to limit their impact – especially as it is universally accepted that the occurrence of global economic crisis is inevitable, even if the timing and origins would always remain a matter for prediction.

Foreign direct investment in times of crisis

Lauge Skovgaard Poulsen and Gary Clyde Hufbauer[*]

The paper compares the current FDI recession with FDI responses to past economic crises. While the decline in outflows from developed countries has been similar in magnitude to that in previous recessions, the recovery in FDI has been much slower than in the past. Inflows to emerging markets, which remained stable during previous economic crises, have experienced an overall decline. Both patterns indicate that the global scale of the current crisis has had a different and more marked FDI response than after earlier individual country crises. Compared with other global economic downturns since the 1970s, the current FDI recession has also been greater in magnitude. (The exception to this was the large FDI plunge in the early 2000s, despite the much smaller economic crisis at the time.) To the extent past FDI patterns can provide relevant insights to the current FDI slump, this could indicate that global FDI flows may remain below 2007 levels until at least 2014. The paper concludes by recommending policymakers to not just further liberalize FDI regimes – the typical response to earlier crises – but rather to use the downturn to completely rethink their FDI policies, with an enhanced focus on promotion of "sustainable FDI".

1. Introduction

In 2007, global foreign direct investment (FDI) flows amounted to a historical high of around $2 trillion – a sum equivalent to more than 16 per cent of the world's gross fixed capital formation (GFCF) at the time.[1] This marked the peak of a four-year upward trend in FDI flows. Along with the subsequent worldwide collapse in real estate values, stock markets, consumer confidence, production, access to credit, and world trade, global FDI flows also began to fall – by 16 per cent in 2008, and when worldwide output contracted in 2009

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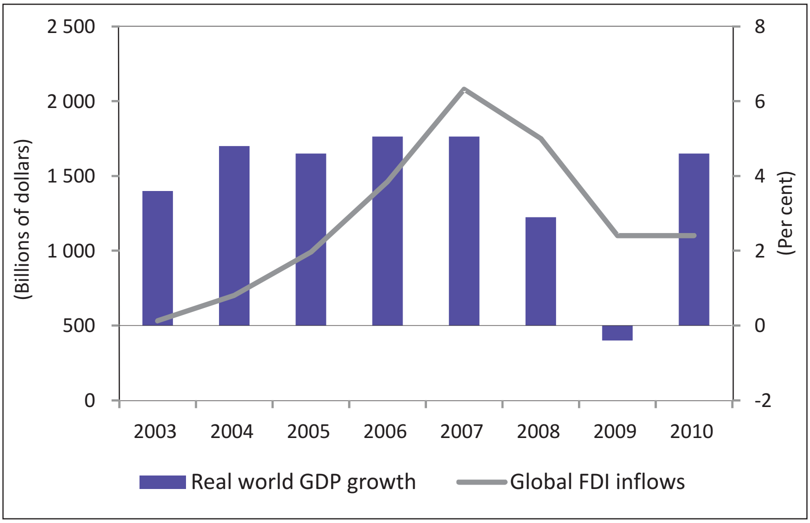
[1] FDI figures are from UNCTAD throughout.

for the first time in sixty years, FDI declined a further 40 per cent. In 2010 FDI stagnated at just above US$1 trillion.

Figure 1. The FDI recession



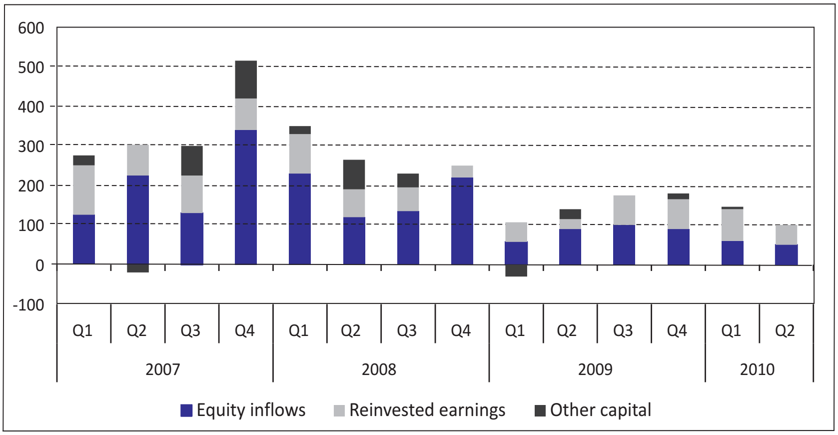
The decline in FDI flows can be attributed to three main factors (UNCTAD, 2009a). Firstly, the global financial crisis has led to liquidity constraints for transnational corporations (TNCs) worldwide, as access to credit has tightened and corporate balance sheets have deteriorated. Even if they wanted to, the capacity of firms to invest has thereby weakened considerably. Secondly, the traditionally strong link between economic growth and FDI flows means that the world slowdown – particularly in the developed world – has further decreased the appetite of TNCs for new investment abroad. Finally, the crisis has probably fostered a more cautious attitude among managers, resulting in a move away from high-risk projects (such as major infrastructure) to safer assets (in the extreme, government bonds).

Disentangling more detailed implications of the crisis for TNCs is difficult, depending, *inter alia*, on the type and extent of production and financial linkages between parent firms and foreign affiliates, sector and industry characteristics, host and home state economic performance, modes of entry (see e.g. Alfaro and Chen, 2010). Rather than analysing in detail the many complex, and at times endogenous, channels through which the crisis has impacted FDI patterns, the aim of this paper is simpler. Taking a bird's-eye view, we ask just how bad the "FDI recession" has been in the wake of the crisis compared to previous such episodes? Has it been unique in terms of either its severity or the political response? Comparing the current FDI recession with FDI patterns during and after past crises may in turn provide insights to how long the FDI slump can be expected to last.

2. The FDI recession in brief

All main FDI components have been negatively affected since 2007 (figure 2). Even after sales and profits of foreign affiliates began to improve in late 2009, parent companies continued to repatriate large shares of their profits, rather than invest in host states (UNCTAD, 2011). Intra-company loans have dwindled also, as TNCs have restructured their operations – for instance, by relocating activities to countries which have weathered the crisis – and compelled their foreign affiliates to help strengthen parental balance sheets at home (UNCTAD, 2009b). As a result, not only have host countries struggled to attract new FDI during the crisis, they have struggled to retain what they already had. As we shall see later, this pattern is reminiscent of past crises, where the fall in more liquid FDI components was the main driver of declines in

Figure 2. Quarterly FDI components for 36 selected countries, 2007Q1-2010Q2
(In billions of dollars)

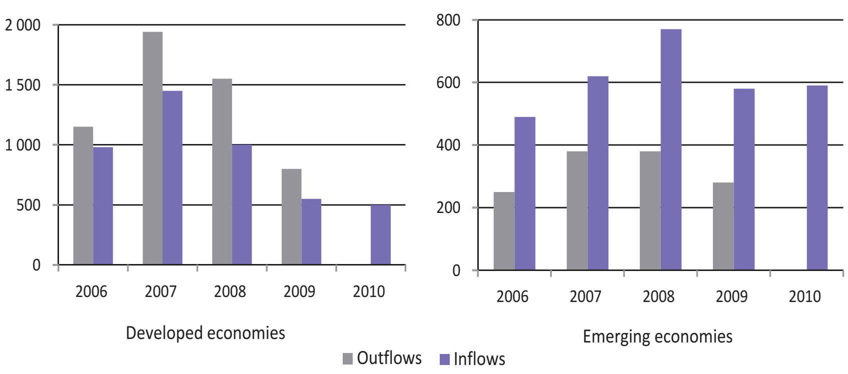


FDI. What is perhaps more worrying, therefore, is the disproportionate fall in equity investment since the beginning of 2009. This is notable, as equity investments reflect the long-term strategic commitment by TNCs to their host countries, and typically are not determined by short-term factors such as liquidity demands or tax-considerations, unlike reinvested earnings and intra-company loans (Desai et al., 2003; Ramb and Weichenreider, 2005). The stagnant level of equity investments may therefore signal that a recovery of FDI flows could take longer after this crisis, a possibility we will return to later.

Given that the crisis started in Western countries, and economic growth is by far the most important determinant of FDI, it should come as no surprise that FDI flows to and from developed countries declined more sharply than the corresponding flows to and from emerging economies (figure 3). The downturn has had a particularly strong impact on Western banks and financial institutions, which as a result had to cancel, postpone, or downscale cross-border mergers and acquisitions (M&As) – the most important mode for FDI.

The global drop in FDI has therefore primarily been due to the steep decline in cross-border M&A deals of developed-country companies since 2007. Despite a slight rebound in cross-border M&As worldwide in 2010, overall these were nevertheless 67 per cent below their level three years earlier.

Figure 3. FDI flows, 2006-2010
(In billions of dollars)



For emerging economies, FDI remained an important stabilizer in the early stages of the crisis. While their net inflows of portfolio investments and bank lending were negative in 2008 (IMF, 2009), their FDI inflows actually increased, albeit at a slower pace than previous years, and outflows grew as well. But as the credit crunch and recession spread to emerging markets in the second half of 2008, both their outflows and inflows of FDI started to decline, and 2009 was therefore the year when the FDI recession became truly global in character. Apart from the drop in M&As, there was a reduction in greenfield investments – a class of FDI that is more important in emerging markets than developed economies – which dropped 15 per cent in emerging economies from 2008 to 2009. In 2010, however, FDI inflows began to rise again, driven by strong performance in much of Latin America and Asia.

Uncertain FDI outlook for the coming years

So what does the future hold? On the one hand, undoubtedly there are economic and political factors at work which will counteract the current slump in global FDI.

Firstly, a number of major emerging economies have weathered the crisis better than developed countries, and developing and transition economies now account for more than half of global FDI inflows – the highest share ever recorded. With respect to outflows, developing and transition economies accounted for more than 25 per cent of global outflows in 2009 – also the highest share on record – compared to less than 10 per cent just ten years earlier. Many "Southern" TNCs are increasingly investing abroad, and particularly so in other emerging markets (Sauvant et al., 2010).

This geographic shift in the distribution of global FDI flows seems likely to continue, as the positive growth prospects in countries like India and China are a strong incentive for TNCs with the necessary funds to invest, particularly through market-seeking and efficiency-seeking FDI.

Secondly, the policy response to the crisis has been rather favourable to TNCs overall. With respect to the international investment regime, some countries are slowly moving towards a re-balancing of the rights and obligations between investors and their host countries

(Waibel et al., 2010). This shift in favour of host countries is not directly related to the crisis, but rather a response to the rising number and impact of investor-state arbitrations over the last decade. Also, it should not be taken as an indication that the international investment regime is unravelling, as investment promotion and protection treaties are still being signed in large numbers, either as stand-alone agreements or as parts of preferential trade agreements. Although the rush to sign investment treaties has slowed compared to a decade ago – and a few countries have even begun cancelling theirs – this is unlikely to have a significant impact on global investment flows (see e.g. Yackee, 2010; Poulsen, 2010).

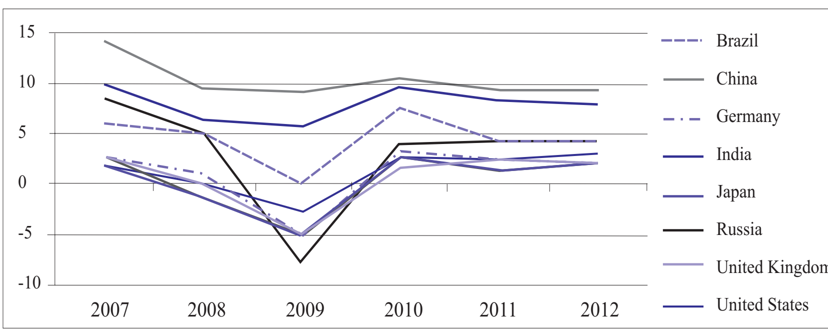
National FDI regimes, rather than investment rules on the international level, are now the main policy drivers of FDI flows. Where data are available, there are no signs that the crisis has led to a protectionist backlash − while expropriation of foreign assets in the natural resources sector was beginning to become fashionable before the crisis in parts of Latin America, for instance, falling commodity prices in the initial stages of the crisis made expropriation less attractive (Lloyd's, 2009). With respect to less extreme forms of FDI restriction, however, recent years have seen an increase in limitations on cross-border M&A activity, particularly when target firms have been considered strategic industries, or when investment has been facilitated through sovereign or quasi-sovereign entities (Sauvant, 2009). These trends began before the onset of the crisis (OECD and UNCTAD, 2010), and although some national bailout packages are likely to have particularly adverse effects on FDI – either directly (by being closed to participation by foreign-owned firms), or indirectly (by allowing government officials greater discretion to favour national firms) – most investment initiatives taken during the crisis have been aimed at facilitating, rather than restricting, FDI (UNCTAD, 2009a). The issue of whether beggar-thy-neighbour policies are on the rise in the trade regime is as yet unresolved,[2] but the general trend is clearly towards greater openness for TNCs in most countries.

Yet, there are also reasons to be pessimistic about the prospects for FDI over the coming years. While the world economy has begun to expand once again, growth remains sluggish in many regions, considering

[2] Compare, e.g. Global Trade Alert (2009) with Rodrik (2009). Also see Hufbauer et al. (2010).

the magnitude of (potential) output lost in recent years (figure 4). And, while China is moving towards private-sector-led growth once again, austerity reforms are likely to slow the recovery in key Western markets. Also, credit is still tight despite low interest rates, which dampens the ability of firms to expand their activities at home and abroad. Finally, the risk of currency wars looms large, as global imbalances persist, and remaining sovereign and bank vulnerabilities heighten concerns about the stability of the global financial system. The crisis itself was a humbling experience for the economics profession, which largely failed to predict its timing and magnitude, and those organizations (including UNCTAD, 2010b) which expect FDI to return to 2008 levels as early as next year, may prove to have been unduly optimistic.

Figure 4. Real GDP growth, selected countries, 2007-2012



Given these uncertainties, it may be informative to look at FDI patterns during past crises for hints about the prospects for recovery in TNCs' investment activity. Not because past events are necessarily a good indicator for present conditions, but rather to see if the current FDI recession is unique in terms of its scale or policy reactions.

3. FDI during past crises

Individual country crises

We begin by looking at FDI patterns during individual country crises. As a benchmark for the 2007 subprime crisis in the United States, Reinhart and Rogoff (2008) assembled historical data on 18 bank-centred financial crises in developed countries. Unlike the current downturn, several of these were relatively minor affairs, and we therefore focus on the so-called “Big Five” systemic financial crises, which all led to major falls in economic performance for several years: Finland (1991), Japan (1992), Norway (1987), Spain (1977) and Sweden (1991) .

Figure 5. Median GDP growth and FDI trajectories after the “Big Five”

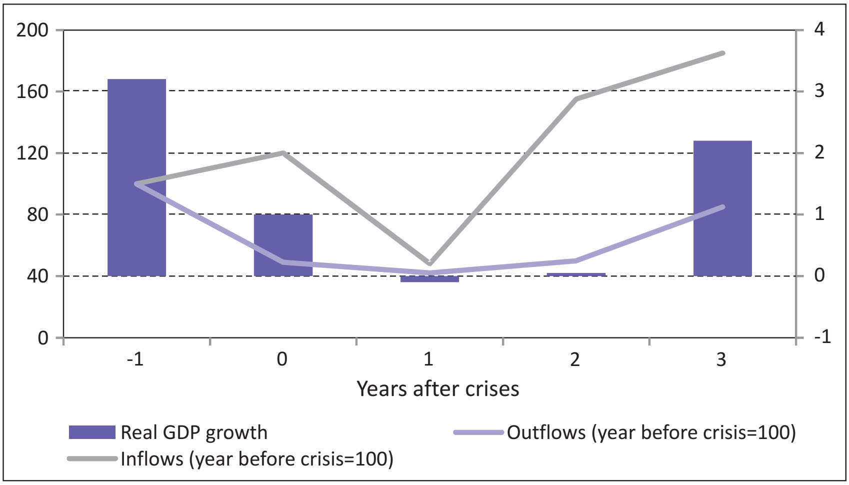
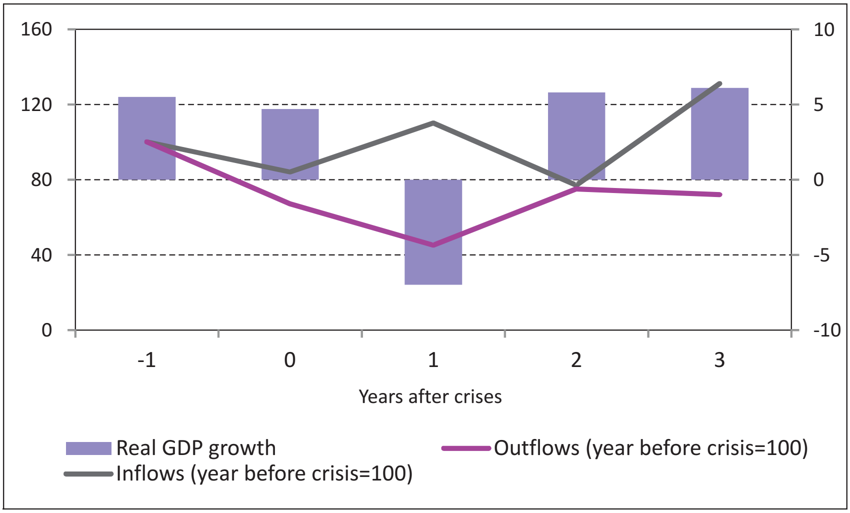


figure 5 plots the median country real GDP growth and FDI trajectories from one year before the crises to three years after. Median rather than mean values are used so that results are not driven by outliers. As the crises were in developed countries, the impact on outflows may be particularly illuminating for the current FDI downturn: when median real GDP growth turned negative, one year into the crises – as global GDP did in 2009 – outflows had fallen as much as developed country outflows fell during the current downturn, by almost 60 per cent. But while that marked the end of the downward trend in outflows after the individual country crises, 2010 figures available at the time of writing indicate that developed country outflows are still contracting two years into the current downturn (UNCTAD, 2010a). So, while outflows had almost returned to pre-crisis levels three years after the onset of the individual country crises, recovery could take longer this time.

Moving on to emerging markets, figure 6 again plots median country real GDP growth and FDI trajectories around seven emerging market crises for which we have data: Argentina (2001), Malaysia (1997), Mexico (1994), the Philippines (1997), Republic of Korea (1997), Russia (1998) and Thailand (1997). By contrast with the comparison between the current crisis and the earlier developed country crises, the data presented in figure 6 indicate that outgoing FDI from emerging markets has been more resilient during the current downturn compared to emerging market crises in the 1990s and early 2000s. Partly due to the increasing internationalizing of "Southern" TNCs and the decoupling of key emerging markets in the early stages of the current crisis, the relative drop after individual country crises was much larger than the approximately 20 per cent decline in outgoing investments from emerging economies observed since 2007.

Figure 6. Median GDP growth and FDI trajectories after 7 emerging market crisis

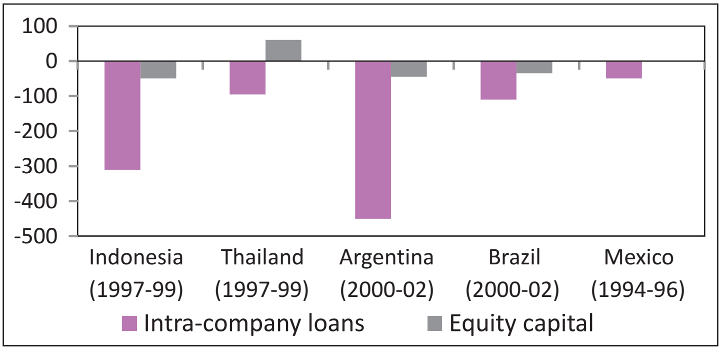


Despite their growing role as sources of FDI, emerging markets are still mostly capital importers. So, for our purposes, inflow patterns are the main interest in the aftermath of the emerging market crises. Several emerging economies experienced falling inward FDI levels during and after their economic crisis. After the 2001 crisis struck Argentina, for instance, inward FDI collapsed to levels similar to those of the early 1990s. Nevertheless, as in the case of developed country crises, inflows to emerging markets were stable overall, or indeed rising, during and after their crises.[3] Stability was often backed up by FDI liberalizing policies. Following its crisis in the mid-1990s, for instance, Mexico liberalized important sectors of its economy over and above its NAFTA commitments (see e.g. Haber, 2005). The East Asian crisis likewise sparked liberal FDI reforms in a number of countries, resulting in considerable policy convergence across the region with respect to FDI regulation (Athukorala, 2003; UNCTAD, 2000, pp. 148 and 150). So rather than fostering FDI protectionism, past crises generally led to increased liberalization – as appears to be the case today. Yet, the resilience of FDI inflows to emerging economies after their earlier crises is in marked contrast to the grim FDI developments in 2009, where M&A deals and greenfield investments declined in most emerging markets – despite the equally open investment policy environment. And although slowly beginning to rise again in 2010, inflows to emerging markets remained more than 20 per cent below their 2008 level.

One indicator of the greater effect on inflows to emerging markets of the present crisis compared to past crises is that earnings and intra-company debt exhibited much more pro-cyclical patterns than equity investments during past crises in emerging markets (World Bank, 2009, pp. 51–54). In order to limit the impact of economic turmoil in host countries without having to sell off assets, TNCs often reduced intra-company loans to a much greater extent than equity holdings (figure 7). For example, United States TNCs in countries affected by the Asian crisis repatriated all their income from the region to parent companies (World Bank, 2009, p. 52). Similarly, while there was a net inflow of United States FDI to Mexico in 1995, the current assets of United States affiliates there dipped while equity components remained stable, suggesting the withdrawal of liquid funds (Graham and Wada, 2000, pp. 794–796). Thus, while TNCs – like portfolio investors – typically pulled out funds from emerging markets during past crises, they did not relinquish their long-term strategic commitment. This is somewhat in contrast to the current downturn, where equity investments have declined substantially in both absolute and relative terms.

[3] This has been observed before. See Lipsey (2001), Sarno and Taylor (1999), Ramstetter (2000), Athukorala (2003) and UNCTAD (1998).

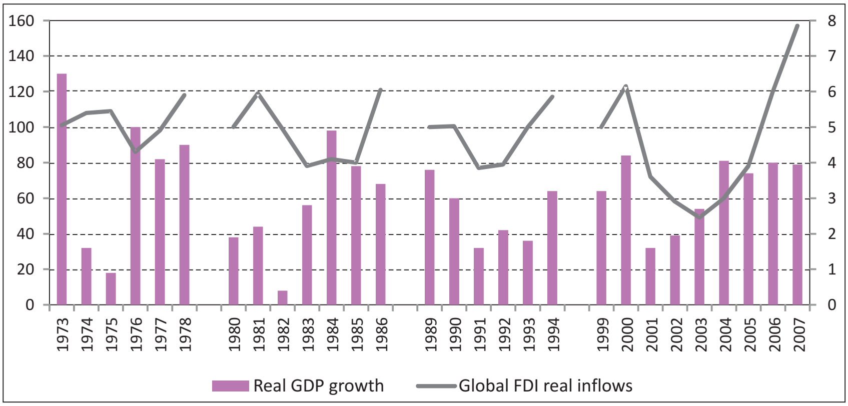
Figure 7. Intra-company loans versus equity components of FDI during financial crises
(Percentage)



Global crises

Having examined the response of FDI to individual country crises, it may be informative to review crises which were not specific to individual countries, but more global in character. We follow Freund (2009) in identifying 1975, 1982, 1991, and 2001 as prolonged global downturns. In these episodes, world real GDP growth (i) fell below 2 per cent; (ii) dropped more than 1.5 percentage points from previous five-year averages; and (iii) was at a minimum level compared to two years before and after. figure 8 plots global real FDI inflows against GDP growth around the four crises.

Figure 8. FDI responses to four global downturns
(Inflows two years before downturns=100)



During the oil shocks and the downturn in the early 1990s, it took an average of three years for FDI flows to recover after their first dip. These swift recoveries took place in the context of policies that were largely favourable towards FDI. During the 1970s and 1980s, both European and American FDI policies were generally liberal. Starting with the United States, the approach towards inward FDI of both the Carter and Reagan administrations was principally based on a doctrine of neutrality (Graham and Krugman, 1995). Though the Committee on Foreign Investment in the United States (CFIUS) was created to keep track of investors coming to the United States, partly due to the rise of Japanese multinationals, it rejected very few M&A deals in practice and the fact of its existence certainly did not imply that the United States was closing its doors to inward FDI. Furthermore, both administrations also strongly supported US investment overseas, both rhetorically and by launching the United States Bilateral Investment Treaty (BIT) programme. Similar developments took place in Europe, where the Single European Act of the mid-1980s liberalized large parts of the European continent to foreign investment (OECD, 1992), and more and more European countries began treaty programmes to protect and promote their investors abroad. Furthermore, the debt crisis and global downturn in the 1980s similarly led the majority of Latin American countries to remove legislative and administrative barriers to FDI, which previously had closed large swathes of the continent to foreign firms (Williamson, 1990). Likewise, in the early 1990s, most countries further liberalized their FDI regimes, despite the downturn (UNCTAD, 2010b).

The policy responses regarding FDI were therefore largely comparable to today's. But just as the three previous global downturns were minuscule compared to the current crisis, so were the initial FDI drops when compared to the collapse since 2007. A more interesting comparison may therefore be the FDI recession of the early 2000s. Here, the halt in developed country M&A deals led real inward FDI to fall by more than 40 per cent in 2001. The decline continued, with 25 per cent in 2002 and a further 12 per cent the year after, which means the FDI collapse then was greater in percentage terms than the one the world is facing now. In 2006, global FDI was still below its 2000 level,[4] which raises the question whether we should expect the current FDI recession to be as prolonged – or even longer – as the recession after 2001?

A return to the early 2000s?

Despite the greater FDI collapse in the early 2000s, the answer could very well be in the affirmative. This is for several reasons. First of all, equity investments have been affected to a greater extent during the current crisis than in the early 2000s (UNCTAD, 2009b). As mentioned above, equity investments are typically made for the long term, and their proportionate decline this time around may suggest that if anything, recovery will be longer than after the 2001 FDI recession.

Second, trade flows have dropped much more during the current downturn than in earlier global crises (Baldwin, 2010). Just as the current crisis is the largest since the Second World War, so has been the trade collapse; world trade may take a while to return to trend levels for the most badly affected regions – notably the United States and the European Union (IMF, 2010).

Third, maintaining liberal FDI policy alone cannot be relied upon to contribute to a faster recovery than the previous crises. At the time of the last FDI slump in 2001, while security concerns prompted several countries to tighten their FDI regulations in the years after 9/11, this did not reverse the overall trend of prior decades, where investment liberalization and promotion "replaced red tape with red carpet treatment of foreign investors" (Sauvant 2009, p. 222). Thus, today's liberal policy environment is no more favourable than those during the past crises.

[4] It should be noted that global FDI would have been higher in 2005 had it not been for the Homeland Investment Act, which created a one-year tax incentive for repatriation and led to a massive withdrawal of retained earnings from US foreign affiliates that year. From around $80 billion in 2004, repatriations rose to almost $300 billion in 2005, and then dropped again to approximately $100 billion in 2006. As a result, reinvested earnings of American affiliates abroad dropped from around $160 billion in 2004 to a negative $10 billion in 2005, and then bounced back to almost $220 billion in 2006 (Bureau of Economic Analysis, Table 7a).

Fourth, although countries like China and India that are rapidly growing in importance as both hosts and sources of investment could thus soften the current FDI recession, one should not exaggerate the contribution of emerging market outflows to global FDI. For now, they constitute only around one-quarter of world FDI flows. So although favourable investment prospects in key emerging markets, combined with increased South-South flows, does imply that emerging market FDI could rebound faster than that of developed countries5 – as they did in the early 2000s – Southern TNCs can not be relied upon to pull global FDI out of its current slump.

Fifth, while world stock markets also plummeted in the early 2000s, global real GDP growth never went below a positive level of 2 per cent. This contrasts with the current downturn, in which the global economy contracted during 2009. This in particularly makes it unlikely that global FDI flows will recover more quickly after the current downturn, than they did after the 2001 plunge. In brief, there are no persuasive reasons to expect FDI to regain pre-crisis levels (around $2 trillion) before at least 2014.

4. Conclusions

When attempting to forecast when, and how, the world will recover from the FDI recession, it is worth keeping in mind that just as predictions of financial resilience before the crisis turned out to be false, so any predictions of recovery could similarly be wide of the mark. This includes our own. But even if the worst of the current downturn has faded in the rear-view mirror, and world FDI bounces back quicker than we expect, do our observations have any implications for investment policymakers?

We think so. First of all, it is important to keep in mind that the scope and duration of the FDI recession depends primarily on how governments address the underlying macroeconomic risks of the

[5] This expectation accords with the results of a June 2010 survey conducted by the Economist Intelligence Unit on behalf of the Multilateral Investment Guarantee Agency (MIGA). According to those soundings, around 40 per cent of the almost 200 surveyed executives expected to increase their investments to developing countries over the next year (MIGA, 2010).

global economy in the coming years – including continued threats to financial stability. Here, FDI policies play only a minor role. And even if restraints on protectionist urges go some way to facilitate investments from abroad – in some cases enhancing the benefits of existing FDI (Moran, 2005) – in most countries, such restraint will do little to reverse the damage resulting from the crisis. Investment policymakers should therefore beware of myopia: in the vast majority of countries, the path of recovery from the crisis will not be paved by ever-greater incentives for TNCs, more favourable investment contracts, or a rush to enter into investment treaties.

Rather than desperately scrambling to increase the volume of FDI flows, officials might instead use the downturn as an opportunity to take a step back and reconsider their thinking. In recent decades – including during times of crisis – host country FDI policies have largely focused on increasing the volume of inward investment. In some cases, this is indeed still necessary. But not all FDI promotes development; larger quantities of FDI flows cannot be the sole indicator of a successful development policy. To increase the positive impact of FDI for economic development, and avoid the adverse consequences, officials should instead consider a "sustainable FDI" strategy, which enhances not only the quantity of investments, but also the "quality" (Vale Center and WAIPA, 2010).

Acknowledging that administrative and political constraints will prevent wholesale reforms of FDI regimes – particularly as the crisis demands a focus on other more pressing policy areas for most governments – a prudent and more realistic approach would be to target the most binding constraints on sustainable FDI promotion (see Hausman et al., 2007). These are bound to be country- and sector-specific. If fairer contract and treaty negotiations can provide the greatest benefits for a country, scarce resources would be best spent investing in more in-house legal expertise. If it is greater links between foreign investors and domestic firms, then providing technical and other support to potential domestic suppliers could prove instrumental (see UNCTAD, 2001). In some cases, environmental damage will be the greatest obstacle to sustainable FDI promotion, while in others, the problem of foreign investors taking advantage of non-transparent and corrupt state institutions is what must be addressed. And so forth.

Suffice it to say, this is easier said than done, and will require considerable expertise and institutional capacity at national and sub-national levels, features which are often absent in emerging markets in particular. And unless carefully implemented, reforms could conflict with investment treaty obligations, and thereby expose governments to expensive investor-state arbitrations. Multilateral organizations, aid-donors and non-governmental agencies will therefore clearly have important roles to play. Academics can contribute, too. Rather than providing long shopping-lists of institutional and governance reforms, they could instead focus on operational methodologies to identify where investment policymakers realistically can get the most out of their scarce resources towards more sustainable FDI strategies. Finally, TNCs can often benefit as well from promoting more sustainable and transparent FDI regimes.

Ultimately, however, policy reforms have to start at home. Governments therefore ought to consider whether the crisis should simply prompt more liberalization in an attempt to attract TNCs – as was the pattern during earlier crises – or rather mark the beginning of sustainable FDI regimes at the national and international levels. In most cases, the balance between the two will do little to prolong or shorten the FDI recession over the next few years, but it will surely have important economic and social welfare implications over the longer term.

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Impact of the crisis on new FDI players: past, present and future of sovereign wealth funds, private equity and emerging market transnational corporations

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In the past 10 to15 years, Western transnational corporations (TNCs) have been joined by at least three new players on the foreign direct investment (FDI) stage: sovereign wealth funds (SWFs), private equity firms and emerging market TNCs. This article considers how "new" these players are, their contribution to global FDI outflows, how they were affected by the financial crisis, and their likely future role. I conclude that, with a few exceptions, SWFs will continue to be marginal FDI players, despite their high visibility. Private equity firms will play a highly volatile role, varying from marginal at times to important at others. Emerging market TNCs, on the other hand, are already quite important and will become even more so, as emerging markets become prime movers of the global economy. I contend that this is to be welcomed, because emerging market TNCs contribute to sustainable development in ways that Western TNCs cannot, given their distinctive capabilities in making and selling products for price-sensitive customers, and their competence in some green technologies. In the long term, the financial crisis will prove merely to have accelerated the inevitable rise of emerging markets as both sources and destinations for FDI.

1. Introduction

The nature of global foreign direct investment (FDI) flows has changed in the past two decades from an involvement propelled largely by Western transnational corporations (TNCs), to one with a more diverse set of players. In the 1980s, most FDI originated from TNCs from developed countries and flowed to other developed countries; developing countries were of only limited importance as hosts of FDI. In the mid-1980s, for instance, only 2 per cent of global outward FDI originated in developing countries, with 98

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per cent coming from countries such as France, Germany, the United Kingdom, the United States, and, more recently, Japan.[1] There is little information on the destination of the 2–3 per cent of outward FDI originating in developing countries at that time, but Wells (1983) estimates that in the 1970s, about two-thirds probably went to other developing countries.

By 2007, when FDI flows had reached an all-time peak of $1.98 trillion, the picture had become more complex, and there were several new players on the FDI scene. First, there was growing FDI from emerging markets, most of it flowing to other emerging markets, but a significant share also going to developed countries.[2] The share of emerging markets in FDI outflows rose from 3 per cent in 1990 to 16 per cent in 2008. Another new category, with very deep pockets and a range of intentions, was the group of sovereign wealth funds (SWFs), which together had $3.9 trillion in assets, compared to the world's total FDI stock of $16 trillion. Beginning in 2005, SWFs began to make FDI-type investments, that is, taking equity positions of 10 per cent or more in individual foreign companies. This created anxiety in G-7 countries, quickly resulting in a tightening of their FDI rules. Finally, a third new player was private equity firms, which engaged in many cross-border deals during the mergers and acquisitions (M&A) boom of the 2000s. During this period, private equity firms devoted almost 70 per cent of their funds to leveraged buyouts, much of it within the developed world.

This article surveys the new players on the global FDI stage, how they were affected by the global financial crisis, and what role they are likely to play in the future. Three issues arise: in the short term, there is the question of whether investors from emerging markets, sitting on huge foreign exchange reserves, took or might take advantage of the crisis to buy companies cheaply or to acquire assets that would otherwise

[1] The inaugural World Investment Report of 1991 notes: "During the 1980s, the number of developed countries which became significant outward investors increased, eroding the established positions of the United States and the United Kingdom. The most important of the new outward investors was Japan: investments abroad by Japanese transnational corporations increased at an annual rate of 62 per cent from 1985 to 1989" (UNCTAD, 1991, p. 4).

[2] Henceforth, the term *emerging markets* refers collectively to developing countries and transition economies, such as China or the former Soviet Union.

be off-limits for national security reasons;[3] in the long term, there is the question of whether the crisis threatens to dislodge developed-country TNCs as the dominant source of global FDI flows; finally, in the context of sustainable development, there is the question of whether and to what extent the new players will facilitate or hinder sustainable development.

2. Sovereign wealth funds

SWFs are "special purpose investment funds or arrangements, owned by the general government" (Banque de France, 2008, p.1). SWFs hold or manage assets, including foreign assets and companies, in order to achieve their goals. By definition, therefore, governments, or their appointed agents, call the shots in these organizations. By 2009, most SWFs had assets under $50 billion; the eight funds with assets over $150 billion accounted for 70 per cent of the assets of all SWFs (see table 1). The top-15 SWFs included only two from developed countries: Norway's Government Pension Fund and Australia's Queensland Investment Corporation. The rest were either from oil and gas exporting countries, e.g. Kuwait, the Libyan Arab Jamahiriya, the Russian Federation, Qatar, Saudi Arabia and the United Arab Emirates, or from Asian exporters with large current account surpluses, e.g. China, Hong Kong (China) and Singapore. SWFs came into prominence in the 2000s as their assets swelled with the rise in commodity prices and current account surpluses in Asia. The proportion of a country's foreign exchange reserves that was assigned to an SWF varied from only 10 per cent, as in China, to as high as 75 or 80 per cent in others.

SWFs are by no means new actors – the one in Hong Kong (China) was created in 1935, and half of the top 50 SWFs were created before 1990. However, their visibility and importance grew in the 2000s, with the number of SWFs nearly doubling by 2008 to 53, and – more relevant to this article – FDI-type investments by SWFs swelled, especially from 2005. In that sense, SWFs can be regarded as new players on the FDI stage. It would appear that SWFs were ramping up their FDI-type investments, although over the entire period in the figure, their

[3] Referring to emerging market firms, for instance, the *World Investment Report 2009* notes: "those with abundant cash at their disposal may take advantage of the present low prices of assets to make new acquisitions in order to strengthen their presence in developed-country markets and foster their technological capabilities" (UNCTAD, 2008, p. 24).

Table 1. The world's 15 largest sovereign wealth funds, October 2009

Home Economy	Fund Name	Assets US$ billion	Inception	Origin	Ratio of SWF to FX Reserves
United Arab Emirates	Abu Dhabi Investment Authority	$627	1976	Oil	13.9
Norway	Government Pension Fund – Global	$445	1990	Oil	8.8
Saudi Arabia	SAMA Foreign Holdings	$431	n/a	Oil	1.1
China	SAFE Inv. Co.	$347.1			0.2
China	China Investment Corporation	$288.8	2007		0.1
Singapore	Govt. of Singapore Investment Corp.	$247.5	1981		1.4
Kuwait	Kuwait Investment Authority	$202.8	1953	Oil	10.6
Russian Federation	National Welfare Fund	$178.5	2008	Oil	0.4
China	National Social Security Fund	$146.5	2000		nil
Hong Kong (China)	Hong Kong Monetary Auth. Inv. Portfolio	$139.7	1993		1.0
Singapore	Temasek Holdings	$122	1974		0.7
United Arab Emirates	Investment Corp. of Dubai	$82	2006	Oil	1.8
Libyan Arab Jamahiriya	Libyan Investment Authority	$65	2006	Oil	0.8
Qatar	Qatar Investment Authority	$65	2003	Oil	8.6
Australia	Australian Future Fund	$49.3	2004		1.8

cumulative FDI was about $70 billion, representing only 1.7 per cent of their assets and less than 1 per cent of global FDI flows. Thus, although SWFs had enormous resources, and despite significant increases in their FDI-type investments from the period 2005–2008, they were marginal FDI players in the overall scheme.

Why, then, have SWFs received so much coverage in the Western press? The most likely reasons are that their assets are enormous, they are controlled by governments, and they operate with a general lack of transparency. In light of this, it is unsurprising that their every move is watched carefully, especially by policymakers, politicians and the media in the G-7 countries, particularly when the governments in question are non-democratic, as is generally (but not universally) the case with SWFs.

Furthermore, after 2005, SWFs made a series of high-visibility investments in quick succession, most of them involving Western financial institutions, such as investment banks, private equity firms, and commercial banks, giving the impression that SWFs were taking advantage of the crisis to snap up shares in institutions that were the cornerstones of Western capitalism. One of the early deals involved China's SWF, the China Investment Corporation (CIC), taking a 9.99 per cent stake in the Blackstone Group for $3 billion just before the firm's IPO, apparently deliberately avoiding scrutiny by staying just under the 10 per cent threshold that would have defined the deal as "direct investment".[4] More broadly, table 2 shows that from July 2007 to October 2008, SWFs from Abu Dhabi, China, Kuwait ,Qatar, Singapore and elsewhere invested $76.8 billion in seven large Western banks: Barclays, Citigroup, Credit Suisse, Merrill Lynch, Morgan Stanley, UBS and Unicredit. Although the stakes held by SWFs in some of these cases were 10 per cent or more, they did not seek control rights; yet, the symbolism of government-controlled entities swooping down on the West's financial crown jewels at a time of crisis was perceived as threatening, even though the financial institutions had themselves sought SWF investments to tide over the crisis. Former United Staes Treasury Secretary Lawrence Summers observed: "The logic of the capitalist system depends on shareholders causing companies to act so as to maximize the value of their shares. It is far from obvious that this will over time be the only motivation of government as shareholders" (Cohen, 2008, p. 6). The SWFs themselves claimed they were simply responsible investors, motivated only by long-term returns and an interest in saving the global economy from further collapse.

Nonetheless, in 2007 and 2008, a flurry of new policies came out of Australia, Canada, Germany and Japan that tightened foreign investment rules, especially on state-owned enterprises.[5] At the June

[4] Subsequently, China Investment Corporation reached an agreement with Blackstone to increase its holding to 12.5 per cent, and in October 2008 the firm confirmed having crossed the 10 per cent threshold (Xin, 2008)

[5] Cohen (2008) sums up the developments: "Past legislation has also been updated in Canada, France, Germany, and Japan—all members, like the United States, of the Group of Seven advanced economies (G-7)—as well as in several other leading OECD countries. As early as December 2005, France issued a new decree mandating

Table 2. Bank investments by sovereign wealth funds, 2007–2008
(Billions of currency units)

Bank	Bank Nat.	SWF	SWF Nat.	Date	Amount (billions)
Barclays	United Kindgom	Temasek	Singapore	25/07/2007	£1($2.05)
Barclays	United Kindgom	China Development Bank	China	25/07/2007	£1.5($3.08)
Barclays	United Kindgom	QIA, Challenger	Qatar	31/10/2008	£4.3($6.94)
Barclays	United Kindgom	QIA	Qatar	31/10/2008	£3($4.84)
Citigroup	United States	Abu Dhabi Investment Authority	Abu Dhabi	26/11/2007	$7.5
Citigroup	United States	GIC	Singapore	15/01/2008	$6.9
Citigroup	United States	KIA, Alwaleed bin Talal	Kuwait	15/01/2008	$5.6
Credit Suisse	Switzerland	QIA and others	Qatar	16/10/2008	€6.5($8.71)
Merill Lynch	United States	Temasek	Singapore	24/12/2007	$4.4
Merill Lynch	United States	KIC, KIA	The Republic of Korea, Kuwait	15/01/2008	$6.6
Merill Lynch	United States	Temasek	Singapore	24/02/2008	$0.6
Merill Lynch	United States	Temasek	Singapore	28/07/2008	$0.9
Morgan Stanley	United States	China Investment Corporation	China	19/12/2007	$5.58
UBS	Switzerland	GIC	Singapore	10/12/2007	Sfr.11($9.75)
UBS	Switzerland	Unidentified fund	Middle East	10/12/2007	Sfr.2($1.77)
Unicredit	Italy	Central Bank of Libya, Libyan Inv. Auth. Libyan Foreign Bank	Libya	17/10/2008	€1.2($1.61)

Source: Banque de France, 2008, Appendix 6, p. 12.

2007 G-8 meeting, the leaders declared that SWF investments should

prior authorization for foreign investments in eleven sectors that may affect 'national defense interests.' In August 2007, Japan revised its regulation of inward investment to address... 'the changed security environment surrounding Japan and trends in international investment activity'. In December 2007, the Canadian government issued 'clarifications' of its rules on foreign investment for State-owned enterprises under the Investment Canada Act. In February 2008, Australia articulated six principles that will now govern reviews of foreign investments by SWFs and other government-linked entities ... And in April 2008 Germany passed new legislation authorizing policy makers to pre-examine selected foreign investments, particularly those coming from SWFs" (p. 9).

not be restricted unless national security was involved, but they also expressed the hope that all parties would cooperate to arrive at a new understanding of how to regulate SWF investments. Out of this emerged a two-track strategy of getting the IMF to work with SWFs to develop new principles on transparency and governance, and getting the Organisation of Economic Cooperation and Development (OECD) to work with the developed nations on regulations of foreign investment by SWFs and other state-owned enterprises (Cohen, 2008).

So, what is the future outlook for SWFs as FDI players? There are conflicting forces at play, and it is hard to be sure how each will evolve in the future. One near certainty is that the amount of resources controlled by SWFs will continue to grow, but at slower rates than once thought. While the financial crisis adversely affected SWF portfolios in 2008 and 2009, fresh inflows offset the losses, according to McKinsey & Co. (Roxburgh et al., 2009). Estimates of their assets under management in 2013 range from \$5 trillion to \$10 trillion, compared to \$3.9 trillion in 2008. Working with the lower end of the range, which seems more realistic today, and assuming that SWFs raise their share of assets in FDI-type investments from less than 2 per cent to as much as 10 per cent by 2013, this would entail annual FDI-type investments of \$80 billion per year for the next few years, equivalent to fully 20–25 per cent of all outward FDI from emerging markets. Thus, in theory at least, SWFs could become important new sources of FDI. Whether that will actually happen depends on two important questions: how likely are host countries to permit FDI-type investments by SWFs, and how likely are SWFs to build the capabilities necessary to make and manage FDI-type investments? I am pessimistic on both grounds.

On the first question, the evidence to date points, surprisingly, to a high degree of welcome by host-countries. In particular, in 2008 the United States accepted SWF investments in financial services that would have been unthinkable only two or three years earlier. No doubt, this was driven by expediency, but even as the crisis eased there was recognition on both sides that they needed each other. This led the SWFs to come together under the auspices of the IMF as the International Working Group (IWG), and negotiate a set of principles and practices to govern their operations. The aim was to reassure developed countries that they would become more transparent and embrace sound governance principles. After a year of negotiations, they subscribed to the IMF's Santiago Principles, a voluntary code that aims to:

- establish a transparent and sound governance structure that provides for adequate operational controls, risk management and accountability;
- ensure compliance with applicable regulatory and disclosure requirements in the countries in which SWFs invest;
- ensure SWFs invest on the basis of economic and financial risk and return-related considerations; and
- help maintain a stable global financial system and free flow of capital and investment.

The IWG's co-chairperson told a news conference in October 2008 that "through the implementation of the Santiago Principles we seek to ensure that the international investment environment will remain open" (Wilson, 2008). Early evidence also suggested that Asian SWFs were following through on their commitment to the transparency of the Santiago Principles. Singapore's largest SWF, the Government of Singapore Investment Corporation (GIC), published its first public management report on its portfolio and reported the size of its losses in 2008. The other Singaporean SWF, Temasek, also issued a more detailed annual report after signing the IWG's declaration. Even CIC, the Chinese SWF, issued a more detailed annual report than hitherto, including its 2008 performance results and a detailed report on its organization structure and staffing (China Investment Corporation, 2008).

The OECD countries made less progress at their end on clarifying important aspects of their policy, such as the definition of "national security interests" or what constituted a "strategic" industry. Many SWFs feared that OECD countries would use these issues as excuses for disguised FDI protectionism targeted specifically at SWFs, a concern that remains unresolved at the time of writing. I suspect, however, that as the crisis passes, OECD countries will fail to openly welcome direct investments by SWFs. This is particularly true in the case of the United States, where even direct investment by state-owned enterprises has been viewed with suspicion. If the United States does not believe that state-owned enterprises – including those listed on stock exchanges – pursue commercial goals, how likely is it that they will believe this of SWFs, which are even more under the Government's thumb? Moreover, the United States Congress can be expected to be even more guarded about SWF investments than the United States executive branch. It was, after all, pressure from Congress that killed the China National Overseas Oil Company's plans to buy Unocal and Huawei's plan to co-invest in 3Com.

I am equally sceptical that SWFs will build the capabilities required to make and manage FDI-type investments. For one thing, the main purpose of many SWFs is to help stabilize the domestic economy when foreign exchange earnings nosedive (e.g., because of falling energy prices); illiquid FDI-type investments do not belong to such a portfolio. Norway's SWF is an example of a fund that has eschewed FDI-type investments: its portfolio consists of investments in over 3,500 companies, with holdings of no more than 1 per cent in any one company. Additionally, 70 per cent of SWF assets belong to oil and gas exporting countries for which protection against predictable volatility in energy prices is essential. There are, however, a few SWFs for which a higher risk-return portfolio may be acceptable or even desirable. These include giant SWFs from tiny countries, such as the Abu Dhabi Investment Authority, or large SWFs from countries with large current account surpluses, such as Singapore's GIC and Temasek, or China's CIC. In the case of CIC, China's vast foreign exchange reserves of $2.2 trillion mean it makes sense for CIC to consider investing a small fraction more aggressively, such as through an SWF.

How likely are these sorts of SWFs to build the capabilities necessary to make FDI-type investments? One inspiring role model for such SWFs is Singapore, whose two funds have an impressive record of long-run performance. Over a 25-year period ending March 2006, Singapore's GIC earned an average return of 9.5 per cent in US dollar terms, and 8.2 per cent in Singapore dollar terms. This was 5.3 per cent above global inflation, defined by GIC as the weighted average inflation of the United States, Japan, and the European Union. In addition, GIC also claims it has out-performed two benchmark indices for global stocks and bonds (GIC, 2008).[6]

Even including the losses suffered in 2008, GIC appears to have earned a long-run return above G-3 inflation or benchmark indices, and

[6] These are Morgan Stanley's World Equity Index and an enhanced Lehman Brothers World Bond Index.

Temasek has a similarly impressive record. Other SWFs can therefore be tempted to emulate Singapore's approach in the hope of earning similar returns, especially SWFs from China or Abu Dhabi that have very deep pockets. But will they succeed in replicating the Singaporean model or will they stumble? One view is that Singapore is a special case because its model of State capitalism is supported by an unusually talented and professional civil service unmatched by countries like Abu Dhabi or even China, not to mention the deep talent in financial services that result from Singapore being a financial hub. According to Park and Estrada:

> "In principle, FDI represents an attractive means of earning higher returns on FX reserves than traditional reserve assets. In practice, the limited institutional capacity and the political sensitivity of State-led FDI severely constrains the ability of developing Asia's SWFs to undertake FDI on a significant scale. Therefore, the potential for developing Asia's SWFs to become major sources of outward FDI is more apparent than real." (Park and Estrada, 2009, p. *v*).

I agree with Park and Estrada's conclusion, but with one important exception – China. I am not sure the Government of China would concede that it could not put together a professionally and competently run SWF along the lines of Singapore's GIC. After all, China has immense financial talent in Hong Kong and overseas upon which it can draw; Hong Kong (China) itself is a financial centre that rivals Singapore. So, if the Government of China made up its mind, it could give CIC sufficient autonomy and protect it from political meddling. By late 2009, there was some evidence that the Government was already moving in that direction. For instance, as noted earlier, it was showing more openness about its operations, and its 2008 Annual Report described its goals as entirely commercial in nature.[7] Moreover, CIC seems to have used the financial crisis to strengthen its internal talent:

[7] CIC's operating principles are described as follows (China Investment Corporation, 2008):

> "a. CIC selects investments based on economic and financial objectives, and an assessment of the commercial return.
> b. CIC allocates capital and assets within the given risk tolerance of the owner to maximize shareholder value.
> c. CIC usually does not seek an active role in the companies in which it invests nor attempts to influence those companies' operations.

"The global financial crisis has led to the exodus of thousands of professionals from United States and European banks and other institutions. In response, Asian sovereign wealth funds are hiring experienced financial talent. For instance, in its most current restructuring, the China Investment Corporation is hiring more than 20 senior professionals from around the globe and has named a former UBS executive to oversee its Special Investments Department, which will take large, long-term positions in publicly traded companies." (Roxburgh et al., 2009, p. 44).

But even if China's SWF imitates its Singaporean counterpart, it will likely proceed cautiously in taking large, long-term positions in publicly traded companies. The 2007–2008 experience of SWFs investing in Western financial service firms has been disappointing; as of October 16, 2008, they had suffered losses of about 20 per cent of initial investment on Credit Suisse, and over 60 per cent on UBS, Morgan Stanley and Merrill Lynch. That was one reason why many SWFs backed off from further investments when the shares of financial institutions were even lower, another reason being the bad experience and internal criticism CIC suffered for its ill-timed investment in the Blackstone group. As of the end of 2008, only 3.2 per cent of CIC's portfolio was invested in large positions in individual companies, with 87.4 per cent in cash funds![8]

Furthermore, it is not easy to build a multi-billion dollar portfolio of diversified FDI-type investments; keep in mind that the world's largest TNC, General Electric, has global assets of $420 billion (2007), and the second largest TNC, Vodafone, has global assets of $250 billion – both built over many years (UNCTAD, 2009, Annex A.1.9, p. 225). It will take time to create a fund with $200–300 billion. Moreover, if CIC really emulates the Singaporean model, I suspect it will look for investment opportunities in other emerging markets, rather than OECD countries, where the chances of earning above-average returns are poorer because of their well-functioning markets.[9] Moreover, investment by

d. CIC seeks long-term, stable, sustainable, and risk-adjusted return."

[8] Interestingly, China initially charged its SWF 4.3 per cent interest on funds provided by the Government but after the financial crisis saw CIC's portfolio deteriorate, the government turned the initial $200 billion contribution from debt into equity. In 2008, CIC reported a global portfolio return of -2.1 per cent (CIC 2008, p. 34)

[9] According to Desai (2008), the accounting rate of return on inbound FDI to the United States averaged only 4.3 per cent, compared to 12.1 per cent for outbound FDI

the Chinese State raises fewer hackles in emerging markets than it does in the G-7, as evidenced by the welcome given to Chinese firms – including state-owned enterprises – in Africa and Latin America.

To summarize, SWFs will find their assets under management growing, and they will be tempted to go for higher returns by making FDI-type investments. However, beyond Singapore, only one or two countries will make significant headway in that direction – China and possibly Abu Dhabi. Press coverage of any and all such moves will likely exceed the real economic significance of the deals; though SWFs could add significantly to FDI outflows from emerging markets, they will probably not make a significant dent on global FDI flows.

3. Private equity firms

Private equity firms consist of leveraged buyout funds, venture capital funds, distressed funds, growth funds and other similar funds that invest in firms whose stock is generally not publicly traded. 70 per cent of the assets managed by private equity firms are of the leveraged buyout variety, in which non-recourse debt is leveraged to take existing companies private. Private equity funds have been around for many years in the United States and they have been an important driver of M&A. In the 2000s, private equity firms had access to abundant cheap funds, from banks, pension funds, insurance funds, wealthy individuals and sovereign wealth funds. This led to resurgence in leveraged buyouts, but with a new twist – many were now cross-border buyouts, which helped fuel global FDI flows. However, there is not a straightforward relationship between the value of M&A deals and officially reported FDI flows, because deals may be partly financed locally or from international sources, neither of which is included in measurements of FDI. At the same time, there is no question that heightened cross-border M&A activity is positively correlated with measured FDI flows.[10]

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from the United States. He concludes that "America is a beautiful country for stock portfolio investors and a very difficult one for direct investors."

[10] *World Investment Report 2000*, on the theme of cross-border M&As, wrestled with this problem, noting: "it is not possible to determine precisely the share of cross-border M&As in FDI inflows. M&As can be financed locally or directly from international capital markets; neither is included in FDI data….Moreover, payments for M&A (including those involving privatizations) can be phased over several years. It is therefore possible for the ratio of the value of cross-border M&As to total FDI flows –

The total assets under management by leveraged buyout firms rose from $399 billion in 2003 to $1,249 billion in 2008, representing a compound growth rate of 23 per cent from 2003 to 2007 and a 38 per cent growth from 2007 to 2008. Data are only available on the country of origin of funds raised by private equity firms, and these indicate that in 2008, North America and Europe accounted for 92 per cent of the total, with only 8 per cent raised in Asia and the rest of the world (Roxburgh et al., 2009, p. 68). However, the share of Asia and the rest of the world was even lower, at 2.5 per cent in 2003. According to UNCTAD, cross-border M&As executed by private equity firms and hedge funds accounted for a growing share of the value of all cross-border M&As, rising from 16.6 per cent in 1996 to a high of 37.8 per cent in the second quarter of 2007, before falling to 11.1 per cent in the fourth quarter of 2008 and only 9.6 per cent in the second quarter of 2009 (see table 3).[11] The trend in the value of cross-border M&As by private equity firms and hedge funds is even more striking: it rose more than ten-fold from $44 billion in 1996 to $470 billion in 2007 before falling to $291 billion in 2008 and $8.7 billion in the second quarter of 2009 (or the annual equivalent of $34.8 billion, lower than even the 1996 level).

The financial crisis took a heavy toll on private equity firms; only hedge funds suffered more severely. The reason was that the cheap funds, leverage, and rising stock markets that made leveraged buyouts (LBOs) possible, unravelled after the financial crisis. Coupled with the global economic slowdown, many private equity firms found themselves in crisis, looking for emergency funding from SWFs and others.[12]

These facts lead to the following conclusions about private equity firms and FDI flows:

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for the world as a whole or for individual countries – to be higher than 1." (UNCTAD, 2000, pp. 10–14).

[11] The UNCTAD cross-border M&A database does not break down the data for private equity firms and hedge funds.

[12] McKinsey & Co. summed it up this way: "The global financial crisis has thrown into reverse the forces that had fueled the growth and success of leveraged buyout (LBO) funds in recent years. From 2002 through 2007, rising equity markets and cheap credit helped buyout firms generate high returns, while the ensuing flood of investor capital boosted buyout assets under management more than threefold. But now, with credit tight and equity markets far below their peaks, buyout funds are struggling … Many companies acquired at the top of the market are performing poorly. And new fundraising has dried up as private equity investors assess their portfolio losses and face large capital commitments to the industry." (Roxburgh et al., 2009, p. 67).

Table 3. Cross-border M&A purchases by private equity firms and hedge funds, 1996–2009
(No. of deals and billions of US dollars)

Year		Number of deals		Value	
		Number	Share in total cross-border M&As (%)	Value	Share in total cross-border M&As (%)
1996		715	12.2	44.0	16.6
1997		782	11.6	55.4	14.9
1998		906	11.3	77.9	11.2
1999		1147	12.7	86.9	9.6
2000		1208	12.0	91.6	6.8
2001		1125	13.9	87.8	12.0
2002		1126	17.2	84.7	17.5
2003		1296	19.6	109.9	26.7
2004		1626	22.0	173.2	30.5
2005		1724	19.5	205.8	22.1
2006		1693	17.7	285.5	25.4
2007		1890	17.6	469.9	27.6
	Q1	*451*	*16.7*	*73.3*	*25.3*
	Q2	*520*	*19.2*	*183.2*	*37.8*
	Q3	*439*	*16.6*	*115.6*	*29.5*
	Q4	*480*	*18.1*	*97.7*	*18.3*
2008		1721	17.7	291.0	24.1
	Q1	*440*	*17.1*	*127.1*	*35.5*
	Q2	*414*	*16.3*	*69.9*	*23.6*
	Q3	*446*	*18.3*	*60.4*	*24.3*
	Q4	*421*	*19.2*	*33.5*	*11.1*
2009		711	21.7	43.6	17.2
	Q1	*362*	*20.5*	*34.9*	*23.1*
	Q2	*349*	*23.3*	*8.7*	*9.6*

Source: UNCTAD, World Investment Report 2009, p. 26 based on UNCTAD cross-border M&A database

Note: Data for 2009 are only for the first two quarters.

1. Private equity firms are relatively new players in the FDI space, in the sense that they contributed to FDI flows during the M&A boom of the 2000s, unlike the M&A boom of the late 1980s, when cross-border deals were rarer.[13] In the 2000s M&A boom, private equity

[13] Interestingly, there is not a single reference to "private equity" or "buyouts" in the 2000 issue of the *World Investment Report*.

firms and hedge funds accounted for as much as one-third of the value of cross-border M&As.

2. Private equity firms were not in a position to take advantage of the financial crisis to pounce on discounted assets. Quite the contrary, private equity firms were unable to go bargain hunting after the crisis, despite large cash holdings, because the credit crunch precluded financial leveraging, which was a crucial part of their business model.

3. LBOs depend on a large supply of cheap capital, and as this supply fluctuates, so does the fate of the private equity industry. As a result, the contribution of private equity firms to global FDI is likely to be highly volatile, with periods of large contribution, followed by periods of little contribution.

So, what does all this portend for the future of private equity firms? In the near term, the expectation is that they will look for smaller deals, and that they will look for opportunities in emerging markets, where growth is still positive, and firms are smaller and cheaper. If history is any guide, it could take one or two decades before LBOs peak again, given the 19-year gap between the last two peaks that occurred on 1988 and 2007. However, I suspect that the next peak could come sooner, because there will be attractive opportunities in emerging markets, as well as opportunities in developed countries that will multiply as internationally competitive emerging market TNCs in mature industries force the consolidation of these industries in developed countries. Some of that consolidation will be done by emerging market TNCs themselves, but private equity firms may also play a part (see Ramamurti, 2009, for a discussion of "global consolidators" from emerging markets in steel, cement, aluminium, beverages, food, meat packing, white goods, PCs, and so on).

4. Emerging market TNCs

Emerging market TNCs are perhaps the most important of the new players on the FDI landscape. These are firms in developing or transition economies that have begun to internationalize through exports, foreign sourcing and direct investment. Many of these firms are in the early stages of internationalization – that is, they may be more active as exporters than foreign producers of goods and services, and their brands are often not well known outside the domestic market – but in due course their overseas investments are likely to swell and their brands will turn global, as shown in the three-stage model in figure 1 (Ramamurti, 2009, p. 420). Western TNCs went through a similar process of evolution and deepening of their international activities before eventually having, in some cases, more employees and assets abroad than at home (Wilkins, 1974). Most emerging market TNCs are still in Stage 1 of the three-stage process, some are in Stage 2, but very few have reached Stage 3.

Emerging market TNCs are not new on the FDI stage. The first discernable wave of outward FDI occurred in the 1970s and led to studies by Wells (1983) and Lall (1983), among others. The wave included the spread of Brazilian and Argentine firms within South America, and Singaporean and Indian firms around South-East Asia. But that wave quickly died down in the 1980s, as the oil shocks and the debt crisis shut down outward FDI by important outward investors, including Brazil and Argentina (though these events did help launch outward FDI from oil-exporters such as Kuwait and Saudi Arabia). By the late 1980s, emerging markets accounted for only 8 per cent of the world stock of outward FDI (see table 4) and an even smaller 2–3 per cent of outward

Figure 1. Three-stage internationalization model

	Stage 1: ***Infant MNE***	**Stage 2:** ***Adolescent MNE***	**Stage 3:** ***Mature MNE***
Importance of home-country CSAs	High	High to medium, and falling	Medium to low, and falling
Ratio of exports to overseas production	Exports exceed overseas production	Exports and overseas production in balance	Overseas production exceeds exports
Geographic footprint	Few countries in home region, unless EMNE is pursuing the low-cost partner strategy	Several countries, with emphasis on home region	Dozens of countries, in all major regions
Brand	Strong at home, unknown abroad	Strong at home, up-and-coming abroad	Strong global brand
Examples	Most EMNEs	Korean MNEs like Hyundai, LG; China's Lenovo; India's Tata Group	Western and Japanese MNEs, such as IBM, GE, Siemens, Sony, Toyota

Note: CSA = country-specific advantage; EMNEs = emerging market multinationals
Source: Ramamurti (2009), p. 420.

FDI flows (see table 5). It wasn't until the mid-1990s that outward FDI from emerging markets began to revive, after Latin America, China, India, and the former centrally planned economies opened up their markets and embraced globalization. As shown in table 5, the outward FDI stock of emerging markets rose six-fold from $145 billion in 1990 to $862 billion in 2000, and almost tripled again by 2008 to $2,582 billion. As a result, emerging market share of outward FDI stock rose from 8 per cent to 16 per cent in 2008, and their share of FDI outflows rose to 19 per cent. This is impressive, considering that outward FDI from developed countries grew at annual rates above 20 per cent in these years.

At the same time, the origin of outward FDI flows continued to be highly concentrated: in both 1990 and 2008, the top-12 countries accounted for 90 per cent or more of FDI outflows and 80 per cent or more of FDI stock of all emerging markets. The following eight developing economies were on the top-12 list in both 1990 and 2008: Brazil, China, Hong Kong (China), Mexico, the Republic of Korea, Singapore, South Africa and Taiwan Province of China. Two countries prominent on the 2008 list but missing from the 1990 list are India and the Russian Federation, and if there was a noticeable regional shift in those 18 years, it was the relative decline of outward FDI from Latin America and the relative rise of investment from Asia.[14]

By 2008, the annual outward FDI flows from emerging markets neared $350 billion. While this was small compared to the $1.51 billion outflow from developed countries, it was comparable to the amounts facilitated by private equity firms, which at its peak involved deals worth $470 billion (2007). It is anybody's guess what fraction of the private equity deal value shows up in official measures of FDI, given the complex financing and staggered payments that are often involved. As a first approximation, it is probably fair to conclude that emerging market TNCs contributed about as much to global FDI flows as private equity firms did at their zenith, and more than 20 times as much as SWFs ever did.

[14] Latin American countries that were on the top-12 list in 1990, in terms of outward FDI stock, fell in ranking by 2008 (Brazil and Mexico) or dropped out from the list altogether (Argentina), while India and Malaysia joined the list and other Asian economies like China and Hong Kong (China) gained in rank.

Table 4. World FDI outward stock and share of top-12 emerging economies, 1990–2009
(Billions of US dollars and per cent)

Region/Economy	1990	2000	2009
World Outward Stock			
Total	**1,785.58**	**6,069.88**	**18,982.12**
-- Developed countries	1,640.41	5,186.18	16,010.83
-- Emerging economies[a]	145.17	883.70	2,582.03
Share of World Outflows			
--Developed countries, % share	*91.87*	*85.44*	*84.35*
-- Emerging economies,[a] % share	*8.13*	*14.56*	*15.65*
Top-12 Emerging Economies (based on 2009 FDI outward stock)			
Hong Kong, China	**11.92**	**388.38**	**834.09**
--% share of emerging economies	*8.21*	*45.04*	*30.99*
Russian Federation	**n/a**	**20.14**	**248.89**
--% share of emerging economies	*n/a*	*2.34*	*9.25*
China	**4.46**	**27.77**	**229.60**
--% share of emerging economies	*3.07*	*3.22*	*8.53*
Singapore	**7.81**	**56.76**	**213.11**
--% share of emerging economies	*5.38*	*6.58*	*7.92*
Taiwan Province of China	**30.36**	**66.66**	**181.01**
--% share of emerging economies	*20.91*	*7.73*	*6.73*
Brazil	**41.04**	**51.95**	**157.67**
--% share of emerging economies	28.27	6.02	5.86
Korea, Republic of	**2.30**	**26.83**	**115.62**
--% share of emerging economies	*1.58*	*3.11*	*4.30*
India	**0.12**	**1.86**	**77.21**
--% share of emerging economies	*0.08*	*0.22*	*2.87*
Malaysia	**0.75**	**15.88**	**75.62**
--% share of emerging economies	*0.52*	*1.84*	*2.81*
South Africa	**15.00**	**32.33**	**64.31**
--% share of emerging economies	*10.33*	*3.75*	*2.39*
United Arab Emirates	**0.01**	**1.94**	**53.52**
--% share of emerging economies	*0.01*	*0.22*	*1.99*
Mexico	**2.67**	**8.27**	**53.46**
--% share of emerging economies	*1.84*	*0.96*	*1.93*

[a] Developing economies plus transition economies of South-East Europe and the Commonwealth of Independent States

Source: Calculated from UNCTAD World Investment Report, 2010, Annex Table 4.

Emerging market TNC contribution to outward FDI has also been more stable and less volatile than that of private equity firms, although it too went through cycles. In 2008, when buyouts engineered

Table 5. World FDI outflows and share of top-12 emerging economies
(Billions of US dollars and per cent)

Region/Economy	1990	2000	2009
World Outflows			
Total:	**2,414.93**	**12,328.88**	**11,009.93**
-- Developed countries	2,295.85	10,947.27	8,206.65
-- Emerging economies##	119.08	1,349.66	2,291.59
Share of World Outflows			
-- Developed countries, % share	*95.07*	*88.79*	*74.54*
-- Emerging economies##, % share	*4.93*	*10.95*	*20.81*
Top-12 Emerging Economies (based on 2009 FDI outflows)			
Hong Kong, China	**24.48**	**593.74**	**522.69**
--% share of emerging economies	*20.56*	*43.99*	*22.81*
China	**8.30**	**9.16**	**480.00**
--% share of emerging economies	*6.97*	*0.68*	*20.95*
Russian Federation	**0.00**	**31.77**	**460.57**
--% share of emerging economies	*0.00*	*2.35*	*20.10*
India	**0.06**	**5.14**	**148.97**
--% share of emerging economies	*0.05*	*0.38*	*6.50*
Korea, Republic of	**10.52**	**49.99**	**105.72**
--% share of emerging economies	*8.83*	*3.70*	*4.61*
Kuwait	**(2.39)**	**(3.03)**	**87.37**
--% share of emerging economies	*-2.01*	*-0.22*	*3.81*
Chile	**1.29**	**20.26**	**80.38**
--% share of emerging economies	*1.08*	*1.50*	*3.51*
Mexico	**0.08**	**39.87**	**79.83**
--% share of emerging economies	*0.06*	*2.95*	*3.48*
Taiwan Province of China	**2.23**	**3.63**	**75.98**
--% share of emerging economies	*1.87*	*0.27*	*3.32*
Singapore	**2.82**	**76.49**	**67.97**
--% share of emerging economies	*2.36*	*5.67*	*2.97*
Mexico	**(6.34)**	**15.50**	**65.26**
--% share of emerging economies	*-5.32*	*1.15*	*2.85*
South Africa	**20.34**	**59.15**	**59.79**
--% share of emerging economies	*17.08*	*4.38*	*2.61*

##Developing economies plus transition economies of south-east Europe and the Commonwealth of Independent States

Source: Calculated from UNCTAD, World Investment Report, 2010, Annex Table 2.

by private equity firms collapsed, and outward FDI from developed countries fell by 15 per cent, it rose by 2 per cent for emerging markets as a whole and by 54 per cent for Brazil, the Russian Federation, India and China (the BRICs) (see table 6). All four BRIC countries registered

Table 6. BRIC outward FDI flows, 2007–2009
(Billions of US dollars and per cent)

Country	2007	2008	*Year-on-year increase*	2009	Comments
Brazil	**7.07**	**20.46**	*+189%*	**10.1**	
Russian Federation	**45.96**	**52.39**	*+14%*	**46.1**	
India	**17.28**	**17.69**	*+2%*	**14.9**	Bharti Airtel's $23 billion merger deal with MTN of South Africa failed for a second time. Sterlite Industries' $1.7 bid for bankrupt United States copper firm, Asarco, still in play.
China	**22.47**	**52.15**	*+132%*	**48.0**	
Total	**92.78**	**142.69**	*+54%*	**98.9**	

Source: UNCTAD 2010, Annex 2.

increases, though Indian firms were constrained by tightening credit in international markets, Russian firms by falling energy prices, and Brazil's 189 per cent increase was from an exceptionally low base. The really special case here is China, whose FDI grew by 132 per cent to $52 billion, due to the fact that Chinese companies did not face a credit crunch, "allowing its corporations the financial leeway to continue investing abroad at a time when foreign competitors had to cut back" (OECD, 2009, pp. 6–7).

In 2009, the financial crisis finally had a negative effect on outward FDI from emerging markets. Among the BRICs, the Russian Federation experienced a 15 per cent drop in the first quarter of 2009, as compared to the same period in 2008. India was projected to drop off significantly as well, and Brazil was expected to drop to a fraction of its 2008 level (see table 6). Only China looked likely to buck the trend by increasing its outward FDI in 2009, despite Chinalco's failure to conclude the $19.5 billion bid for a stake in the Australian mining firm Rio Tinto.

To summarize, the financial crisis slowed or even reversed the rate of growth of outward FDI from emerging markets, but these countries still did much better than developed countries and contributed much more to outward FDI flows than either SWFs or private equity firms. In 2008, outward FDI flows increased for all four BRIC countries, but the early evidence from 2009 indicated that only Chinese TNCs would see continued growth in outward FDI, helping to fulfil the Government's "go global" policy – despite resistance to Chinese investment in many developed countries (Davies, 2009).

Emerging Market TNC Contribution to Sustainable Development

In the longer-term, there are at least two important questions about emerging market TNCs and sustainable development that are worth examining: will the upward trend in FDI by emerging market TNCs continue for another decade or two, and, if it does, would that be good for sustainable development? I believe the answer on both counts is yes.

Consider first the sustainability of the emerging market TNC phenomenon. One cannot take the current trends for granted, because in the past, outward FDI from developing countries has fizzled out after showing promise, notably after the first wave of the 1970s. There is also no question that emerging market TNC expansion in the 2000s was fuelled by unprecedented access to cheap capital, high growth rates in the home market, and export opportunities in developed countries, particularly the United States. It is hard to say when these "perfect storm" conditions will recur in the future. I will, however, address one aspect of the emerging market TNC phenomenon that has bearing on the sustainability of their international expansion, and that is whether emerging market TNCs posses real competitive advantages that can be the foundation for lasting and profitable internationalization.

On the surface, emerging market TNCs may not appear to possess real competitive advantages, because, unlike established Western TNCs, they normally do not possess cutting-edge technologies or strong global brands (Mathews, 2002). Their spending on R&D or advertising, for instance, is generally not in the range of 5–10 per cent of sales, as is the case for leading Western TNCs. Other experts have argued that emerging market TNCs are merely exploiting emerging markets' country-specific advantages, such as cheap labour (e.g. in India), access to raw materials (e.g. in Brazil or the Russian Federation), or cheap capital (e.g. in China), rather than knowledge-based capabilities, which are firm-specific and more sustainable (see, for example, Rugman, 2009). The implication is that the competitive advantages of emerging market TNCs are imitable and hence ephemeral.

These arguments are flawed, as I have discussed elsewhere (Ramamurti and Singh, 2009, pp. 399-426; Ramamurti, 2009). First, country-specific advantages are in fact not readily available for exploitation by all firms located in a country, as some assume. For example, China may have a high savings rate but the resulting cheap capital is available only to some Chinese firms (namely State-owned enterprises) and not others (local private firms). Similarly, India has inexpensive talent, but exploiting that talent requires skills and local embeddedness not possessed by all firms. More importantly, as discussed in Ramamurti and Singh (2009, pp. 399–426), emerging market TNCs have succeeded in their home markets because they:

(1) have a really deep understanding of local consumers, who are much poorer than Western consumers and have quite different needs and preferences;

(2) are very low-cost players, whose methods for cost reduction are not easily imitated by Western firms;

(3) are strong in mid-tech industries that are neither so simple that any emerging market firm can succeed in them nor so sophisticated that they are dominated by Western TNCs; and

(4) know how to operate effectively in environments characterized by weak political and economic institutions (on this point, see Cuervo-Cazurra and Genc, 2008).

These are significant and sustainable advantages that, along with country-specific advantages, enable emerging market TNCs to expand not only into other emerging markets but under certain circumstances also into developed countries (on emerging market TNC internationalization strategies, see Ramamurti, 2009, pp. 399-426). Over time, I anticipate that Western TNCs will acquire some of these capabilities and learn to thrive in emerging markets, but I also anticipate that some emerging market TNCs will build capabilities in technology and branding that will rival those of Western TNCs. In other words, a convergence in capabilities between emerging market TNCs and Western TNCs may occur over two or three decades, as it has, for instance, between Western firms and leading Japanese or Korean TNCs. It is certainly possible that Western TNCs are more likely than emerging market TNCs to emerge eventually as winners, but in the interim, I see emerging market TNCs doing quite well internationally, especially because two-thirds of world GDP growth in the future will occur in emerging markets and it will take Western TNCs time to beat emerging market TNCs at their own game.

On the second question of whether emerging market TNCs will contribute to sustainable development, I think the answer is a resounding yes. The contributions that emerging market TNCs have made to sustainable development have been largely overlooked; one aspect of sustainability is inclusive growth, and in that sense emerging market TNCs have contributed far more than Western TNCs to serving the middle class and the poor in emerging markets. The inclusive growth practices of emerging economy TNCs have also spurred developed-country TNCs to adopt such practices. For instance, Unilever's strategy of serving the poor in developing countries with low-priced single-serve product sachets has received much publicity (e.g., Prahalad, 2004), but this strategy was a response to the drubbing it received in India at the hands of local firms like Nirma that captured a large slice of the detergent market with an ultra low-cost, branded product. Nokia's low-cost cell phones were its response to the competition the firm encountered in China from local firms such as Ningbo Bird and Amoi. As a few final examples, Citibank and Barclays' embrace of micro-finance grew out of the demonstrated success of Bangladesh's Grameen Bank, not the other way around, while Pfizer's and Novartis's embrace of generic drugs and new approaches to R&D emerged as a response to competition from emerging market TNCs such as Ranbaxy, Dr. Reddy's, and Teva.

Consider further the case of Bharti Airtel, which brought ultra low-cost wireless telephone service to more than 110 million users in India. Its average price per minute is \$0.01–\$0.02, compared to 10-20 times as much in developed countries. Bharti Airtel has achieved low costs through a unique business model involving outsourcing and risk partnership with suppliers. While 99 per cent of billing is post-paid in developed countries, it is exactly the other way around in Airtel's case, because prepaid service takes out the risk of billing errors and defaults. The company developed original methods to sell minutes in very small increments to far-flung users. Bharti's average revenue per user per month was under \$6 in September 2009, compared to \$51 for Verizon in the United States. Yet, Bharti Airtel has been highly profitable and had a market capitalization in 2009 of \$25 billion. Had it been up to Western TNCs, such as Vodafone or AT&T, wireless service in India might have been provided at much higher prices to a thin slice of the Indian population, compared to the hundreds of millions who enjoy telephone service today.

Local firms and emerging market TNCs have also pioneered innovative approaches to serving low-income consumers with low-cost products, appropriate technologies, and novel methods for distribution and marketing. This results in more jobs, more local sourcing, and more suitable technology (and therefore more technological spillovers) than would have been generated by Western TNCs. For these reasons, emerging market TNCs are generally better adapted to emerging markets than Western TNCs. The success of emerging market TNCs in other emerging markets is sometimes seen as the result of South-South affinity, but I suspect it has more to do with the fact that emerging market TNCs bring products and processes better suited to these markets.

There is much discussion in the mainstream literature on positive knowledge spillovers in developing countries from Western TNCs to local firms (e.g. Meyer and Sinani, 2009), but hardly any recognition of the "reverse spillovers" from emerging market TNCs and local firms to Western TNCs. Emerging market TNCs are spreading their innovations to other emerging markets, directly through FDI, and indirectly by training Western TNCs on how to succeed in emerging markets. Western TNCs are slowly waking up to the fact that they can learn valuable lessons from emerging market TNCs for exploitation not only in emerging markets but also occasionally in developed markets.[15]

Emerging market TNCs are global welfare enhancers for other reasons as well. They are stirring up cozy global oligopolies of Western firms in, for instance, telecom equipment, pharmaceuticals, regional jets and consumer goods. By serving as low-cost partners in industries such as information technology, software development, knowledge-process outsourcing, toys and textiles, emerging market TNCs like Infosys, TCS, or Li & Fung help keep down costs for consumers everywhere. By investing in mature industries, such as steel, cement and aluminium, in developed countries, emerging market TNCs such as Tata Steel, Cemex, and Hindalco are helping to restructure and rationalize industries that might otherwise shut down altogether in these countries.

[15] See, for example, GE's admission in (Immelt, Govindarajan, and Trimble, 2009) that "success in developing countries is a prerequisite for continued vitality in developed ones," (pp. 3–4) or the recognition that "if GE doesn't come up with innovations in poor countries and take them global, new competitors from the developing world—like Mindray, Suzlon, Goldwind, and Haier—will" (p. 5).

Emerging market TNCs are also contributing to sustainable development in another sense – by helping to develop "green" technologies. One of the world's top-five wind energy firms is Suzlon, an Indian company that came from nowhere to become a global player with unmatched cost structure, because 85 per cent of its headcount is in low-cost countries, while the other four leading firms have 70 per cent or more of their headcount in high-cost countries (see Ramamurti and Singh, 2009, pp. 147–152). Similarly, in solar energy, Chinese firms like Suntech and Sunergy aspire to become leading players. A third example is Petrobras, a Brazilian TNC, which has been the world's largest buyer of ethanol for blending with gasoline and has provided R&D and infrastructural support to local suppliers, as a result of which gasohol accounts for 15.7 per cent of Brazil's fuel consumption.

Not all emerging market TNCs are technological laggards simply trying to catch up with Western TNCs: in green technologies, more than a few are shaping up to be "global first-movers" (Ramamurti and Singh, 2009, pp. 146–152 and 411–412).

5. Conclusions

We have examined the past, present, and future prospects for three new players on the FDI stage: SWFs, private equity firms, and emerging market TNCs. Our conclusion with regard to SWFs is that assets under their management will grow, and they will be tempted to go for higher returns by making FDI-type investments, but other than Singapore, only one or two countries might make significant headway in that direction: China and the United Arab Emirates. Press coverage for any and all such moves will exceed the real economic significance of the deals, and SWFs will probably not make a significant dent on global FDI flows but may add significantly to FDI outflows from emerging markets.

Private equity firms have played a much bigger role in outward FDI in recent years, but their role has shrunk dramatically after the financial crisis. I expect there will be a revival of FDI from private equity firms as credit eases and opportunities for industry consolidation and restructuring present themselves in developed countries, partly as a result of heightened competition in mature industries from emerging market TNCs. At the same time, private equity firms will pursue opportunities more vigorously than before in emerging markets.

The most important new player on the FDI stage is the emerging market TNC. As discussed, emerging market TNCs already account for almost 20 per cent of global FDI outflows, and their share has steadily drifted upwards, even during this crisis. But more importantly, emerging market TNCs contribute to sustainable development, because their products, processes, pricing, and marketing are all better suited to emerging markets than what Western TNCs typically have to offer. Emerging market TNCs also benefit consumers and producers in developed countries by breaking up oligopolies, lowering prices, supplying cheap but good inputs, and helping to restructure rust-belt industries. Finally, a number of "global first-movers" will emerge out of emerging markets in tomorrow's "green" industries. China and India will be among the leading developers and adopters of "green" technologies, because of the size of their markets and the technical and entrepreneurial talent available in these countries.

To be sure, it will take a long time for emerging market TNCs to rival Western TNCs in importance, but their share of world outward FDI flows will slowly increase, as it has in the last decade. This will also accelerate FDI inflows into emerging markets, because half or more of their direct investments go to other emerging markets. In addition, emerging markets will become magnets for inward FDI from developed countries, because of their high rates of growth and large, low-cost talent pools. Indeed, in 2009, for the first time, emerging markets were expected to attract more inward FDI than developed countries.[16] To be sure, this will change as growth rebounds in the developed world, but what seemed like an aberration in 2009 could soon become the

[16] "FDI flows to emerging markets have held up better because their overall economic performance has been much better than that of the developed world, which has experienced its worst recession since the Second World War. Much of the superior performance of emerging markets is, of course, due to the continued fast growth of China and India. However, even if China and India are taken out of the equation, most emerging markets will have outperformed the developed world in 2009. Emerging markets have thus to some extent "decoupled" from the developed economies….. Finally, the increased share of emerging markets in outward investment is increasing the share of emerging markets in inward flows because a disproportionate share of outward investment by emerging markets goes to other emerging markets." (Kekic 2009, p.3).

norm.[17] Still, there are several uncertainties ahead. One is whether the heightened recognition among Western MNEs of the importance of emerging markets will result in their gobbling up fledgling emerging market TNCs via mergers and acquisitions. Another is whether emerging market governments will prevent that from happening by tightening FDI rules or by applying entirely new tools to the task, as when China used its anti-monopoly law to block Coca-Cola's bid for Huiyan Juice Group. In other words, going forward, both the strategies of Western TNCs and the policy response of host emerging markets are clouded by uncertainty. What is certain, though, is that emerging markets will become far more important as both sources and destinations for FDI, as they become the engines of global growth.

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[17] Kekic (2009) notes that almost 60 per cent of companies surveyed by the Economist Intelligence Unit expect to derive more than 20 per cent of their total revenue in emerging markets in five years, compared to 31 per cent at present, suggesting that "the shift in the distribution of global FDI flows in 2009 is a longer-term development and not just a transitory phenomenon" (p. 3).

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Enhancing the contribution of FDI to development: a new agenda for the corporate social responsibility community, international labour and civil society, aid donors and multilateral financial institutions

Theodore H. Moran *

Both positive contributions and negative damages from foreign direct investment are greater than even the most sophisticated of today's models and estimating techniques can portray. Securing these positive contributions and avoiding the negative damages requires strategies to correct for market failures, to supply public goods and international standards, to capture positive externalities and limit negative externalities. Members of international civil society, labour groups, corporate social responsibility advocates, international donors, and multilateral lenders should fashion their agenda more closely – as outlined here – to provide those external pressures and actions needed to optimize the impact of mainstream transnational corporate activities on host country growth and welfare. The findings reported here should not in any way undercut the efforts of those who simply want to pressure transnational corporations to "give back" more to the communities where they operate. Corporate charity surely has its place, but the pro-poor sustainable development policy community will want to focus on the larger – and in many ways more important – set of targets sketched out here.

1. Introduction

This article summarizes new insights about the relationship between foreign direct investment (FDI) and development, with the aim of offering a fresh perspective for the corporate social responsibility (CSR) community,

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international labour and civil society, aid donors, and multilateral financial institutions.[1] The target for this article is an audience that I shall label, awkwardly, the *pro-poor sustainable development policy community.*[2] The common aim of this community, I postulate, is to maximize the contribution of FDI to the long-term economic and social welfare of the largest number of people in the developing world.

Developing country policymakers retain the principal responsibility for formulating policies toward FDI. But there are many economic and social obstacles to the formation of optimal host-country policies, and – as this article will make clear –external action beyond what host-country policymakers can accomplish on their own is often needed to capture the benefits of FDI and minimize the costs or avoid the damages. This leaves important tasks that need to be performed by outside members within the pro-poor sustainable development community.

The evidence summarized here diverges from the widely criticized Washington Consensus (that "FDI is good, and the more the better") in fundamental ways. The analysis shows that both positive contributions and negative damages from FDI are greater than even the most sophisticated of today's models and estimating techniques portray. Securing these positive contributions while avoiding the negative damages requires strategies to correct for market failures, to supply public goods and international standards, to capture positive externalities and escape negative externalities. Here is where action by international civil society, CSR advocates, international donors, and multilateral lenders is vitally needed. In this paper, I shall make the somewhat novel argument that members of the pro-poor sustainable development policy community should more closely fashion their agenda to provide those external pressures and actions needed to

[1] This article draws upon my forthcoming book*, Foreign Direct Investment and Development: Launching a Second Generation of Policy Research, Avoiding the Mistakes of the First* (Moran, 2011).

[2] As explained later, the new agenda proposed here is intended to cover all those interested in socially responsible investing, social investing, mission-driven investing, sustainable and responsible investing, blended value investing, values-based investing, mission-related investing, ethical investing, responsible investing, impact investing, programme-related investing, triple bottom line investing, and environmental, social, and governance investing.

enhance the impact of mainstream transnational corporate activities on host-country growth and welfare.

I call this a "somewhat novel" approach since in some areas – most notably the Extractive Industry Transparency Initiatives (EITI[3] and EITI++[4]) and associated anti-corruption and environmental protection efforts – CSR supporters, international civil society organizations and local NGOs, aid donors, and multilateral financial institutions are already well advanced along the lines advocated here. But even in the arena of the Extractive Industry Transparency Initiatives, I shall show that new actions and subtle modifications are needed.

This approach is also somewhat novel because it may appear to be rather dismissive of simply applying pressure on transnational corporations (TNCs) to "give back" more to the communities where they operate, or to treat their workers better. This is not because clinics and schools, and social welfare projects are a bad idea, or because good labour standards are not important, but because conventional CSR preoccupations should not substitute for actions to enhance the larger contributions that well-structured, well-managed mainstream FDI activities can make to pro-poor sustainable development, nor divert attention from the harmful consequences of poorly structured and poorly managed FDI activities even when surrounded by nice schools and clinics and relatively clean environments. I recognize that I am not the first analyst to be sceptical of TNCs' philanthropy, but I hope to provide fresh insight into what is needed to enhance the contribution of FDI to the long-term economic and social welfare of the largest number of people in the developing world on the part of those who want to "do good".

2. A fresh look at the relationship between FDI and development

The research project that underpins the analysis offered here has generated insights in seven areas that might be useful for shaping the agenda of external actors who populate the pro-poor sustainable development policy community.

[3] Extractive Industry Transparency Initiative, http://eitransparency.org.

[4] Extractive Industry Transparency Initiative Plus Plus, htpp://web.www.worldbank.org.

2.1 FDI in different sectors pose distinctive challenges

The first insight is the most obvious: the challenges associated with optimizing the contribution of FDI to development differ dramatically depending upon the sector: FDI in natural resources, FDI in infrastructure, FDI in agribusiness and horticulture, FDI in manufacturing and FDI in services.[5] The public policies and societal pressures needed to produce beneficial development outcomes diverge in fundamental ways, and strategies to produce favourable outcomes (and avoid disastrous results) need to be devised separately. The starting point in fashioning an agenda for the pro-poor sustainable development policy community therefore is to understand each type of FDI on its own terms. It makes no sense to jumble recommendations for how to deal with FDI in Nigerian oil, FDI in Argentine electricity, FDI in Kenyan cut flowers, FDI in Honduran sweatshops, FDI in Malaysian disk drive plants, and FDI in Mexican retail chains.

From an analytical point of view, moreover, mixing data and trying to come to overarching conclusions about how one phenomenon ("FDI") affects another ("development" or "growth") is likely to lead to mistakes and errors. Many of the best known studies – such as the widely cited article by Borensztein et al. (1998), "How does foreign direct investment affect economic growth?"– get into trouble by combining FDI data from all sectors into one single variable. The Borensztein team concluded that FDI can have a positive impact on economic growth only when the host country has already reached a certain human resource threshold, despite abundant evidence elsewhere (see below) that manufacturing FDI can bring substantial benefits to even the poorest host economies. The Borensztein result probably derives from the fact that their FDI measure in low human resource countries is dominated by extractive sector investment, though it is unclear what kinds of FDI were included in the study. The policy reader of the Borensztein article might conclude that attraction of FDI in manufacturing and assembly for the poorest states, and external market access for manufactured exports from the poorest states, were not worthwhile endeavours, whereas (as noted later) just the opposite is the appropriate conclusion.

[5] To be sure, each of these categories of FDI can be further subdivided – in particular, into low-skilled manufacturing such as garments and footwear, and higher-skilled manufacturing such as semiconductors and disk drives, as the subsequent text will point out.

In general, the differences between these kinds of FDI are sufficiently great that any studies that attempt to find the impact of FDI on host-country welfare or growth by mixing all kinds of FDI together must simply be discarded and redone. The list of such studies whose usefulness must now be questioned is long, and includes works by many distinguished names.[6]

This paper will concentrate on FDI in the extractive sector, and FDI in manufacturing – and even in the latter it will be important to separate FDI in low-skill activities like garments and footwear, from FDI in higher-skill activities like auto parts and computers.

2.2 Is FDI in natural resources a "curse"?

After our first simple insight of separating FDI into distinct types, the second insight is also straightforward: a rich natural resource endowment can indeed be a curse, but need not be such. This insight is discussed extensively by others, including Auty (1994), and Sachs and Warner (2001).

In aggregate terms, the finding that natural resource abundance is associated with lower than expected national growth rates is highly sensitive to the time period selected, with numerous counter-trend examples. The negative outcomes in Angola, Equatorial Guinea, Democratic Republic of Congo and Nigeria are countered by positive developmental impacts in Argentina, Botswana, Brazil, Chile, Colombia, Indonesia and Malaysia. The specific problems associated with the "Dutch disease" have proved readily manageable with appropriate macroeconomic policies.

The difference between negative outcomes and positive outcomes from FDI in natural resources centres on the well-established need for transparency in revenue streams, for controls to prevent corruption, and

[6] Examples of studies that must be questioned due to lack of differentiation between distinct kinds of FDI include V. N. Balasubramanyam, M. Salisu, and David Sapsford (1996); E. Borensztein, J. De Gregorio and J. W. Lee (1998); Barry P. Bosworth and Susan M. Collins, (1999); Luis De Mello (1999); Jon D. Haveman, Vivian Lei, and Janet S. Netz (2001); Helmut Reisen and Marcelo Soto (2001); Niels Hermes and Robert Lensink (2003); Jong Choe II (2003); Maria Carkovic and Ross Levine (2005); Bruce Blonigan and Miao Grace Wang (2005); Robert Lensink and Oliver Morrisey (2006), among others.

for measures to set and enforce best-practice environmental standards (UNCTAD, 2007). Dealing with the "resource curse" has become the model for demonstrating that extra-market forces are needed to enable developing countries to optimize the gains from FDI: multilateral institutions like the World Bank must work with industry groups, environmental NGOs, and others to set common standards for dealing with the environment and rights of indigenous people, and to fund capacity-building for official enforcement and civil society monitoring. The Extractive Industry Transparency Initiative is advancing the norm of publication and verification of investor payments and government revenues from oil, gas and mining. Additional NGOs (Publish What You Pay, Revenue Watch Institute, Transparency International, Oxfam, and Global Witness, and others) help with capacity building for host officials, host legislators and local NGOs auditors, and keep watch over outcomes. The EITI + + agenda of the World Bank aims to provide technical assistance, backed by a trust fund, for all aspects of resource management. As the upcoming exploitation of new oil discoveries in Ghana illustrates, the need for external support to ensure good governance of FDI in natural resources is not limited to the poorest states – an observation that will be important later in discussing whether the World Bank and regional development banks continue to have a role to play in middle-income developing countries.

Still, the EITI + + endeavour is a work in progress, requiring specific country commitments and timetables covering investors of all nationalities – including both members and non-members of the Organisation for Economic Cooperation and Development (OECD) – backed by measures to validate performance by the EITI secretariat. Forty-one of the largest oil, gas, and mining companies have committed themselves to support the EITI, but many still oppose company-by-company reports of payments to the government. Debate about this has been renewed by passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 that includes a provision requiring oil, gas and mining companies registered with the United States Securities and Exchange Commission (SEC) to publish how much they pay to foreign countries and the Government of the United States in their annual reports. In the United States, other TNCs registered with the SEC fear that they will be put at a competitive disadvantage. Rightly so! They must now recognize that a requirement for company-by-company reports within EITI compacts will serve the interests of the most conscientious investors, by forcing all participants (including those from China, India, the Russian Federation and elsewhere) to subject themselves to equal transparency. The majority of international resource investors (including those that appose disaggregation) recognize that concerns that individual company disclosure would be commercially disadvantageous are in reality minor or non-existent, and no company involved in disaggregated payment disclosure has later had its contract cancelled or renegotiated as a result (Dumas, 2009). Thus, socially responsible investors should support company-by-company reports in their own self-interest. Furthermore, extractive industry investors can also play a powerful role in persuading new host authorities to join wholeheartedly in the EITI process.

My research shows, however, that optimizing the contribution of FDI in petroleum and minerals to development requires three somewhat controversial extra additions to the EITI + + agenda. The first is a need for external assistance in negotiating and (perhaps) renegotiating extractive industry FDI contracts. The World Bank Group and regional development bank already provide guarantees, insurance, and dispute settlement processes that help ensure contract stability. It is now becoming clear that the mantra that contract negotiations should be regarded as private undertakings between TNCs and host governments whereas enforcing the contracts as a public good is not sustainable (Dumas, 2009). Multilateral financial institutions, bilateral assistance agencies and international civil society groups need to provide assistance akin to the support for renegotiating extractive sector contracts – and bringing transfer pricing into line – in Liberia after the election of President Ellen Johnson Sirleaf, as discussed in Gobal Witness (2006, 2007) and Publish What You Pay (2009).

Second, as part of an expanded EITI + + agenda, multilateral training and support programmes need to guide host-countries to place greater emphasis on progressive taxes (income taxes) rather than regressive taxes such as royalties and production-sharing agreements (Otto et al., 2006). This recommendation may take some in the pro-poor sustainable development policy community by surprise, since such an approach generally means lower up-front payments to the host government, while the foreign investor recovers the initial investment. But progressive taxes (even with higher tax rates) make the attraction of FDI into the extractive sector easier, and – most importantly –

allow host authorities to benefit more fully when oil, natural gas and mineral prices rise. Between 1991 and 2003, the top 10 foreign-owned mining companies in Chile paid taxes of $2.1 billion, in contrast to payments of $9.7 billion on the part of the two state-owned mining companies, despite greater output and lower costs, principally because they subtracted accelerated depreciation on new properties (ICMM, 2007). When accelerated depreciation finished, the tax payments of one foreign-owned mine alone (Escondida) climbed from almost nothing, to $423 million in 2004. As a practical matter, however, most developing countries will simple not want to wait five or more years before receiving any tax revenue, so a mix of a (low) royalty and an income tax (even an excess profits income tax) is perhaps the most favourable outcome

Third, recent experience shows that there is a need for eyes-wide-open caution about earmarking a share of extractive industry payments to be given to local communities. The history of some countries, like Nigeria, shows that local communities where natural resource investments are made are often left with very little of the revenue captured from those investments. However, contemporary evidence concerning the allocation of revenues directly to local authorities reveals that the latter have weak planning capability, little experience with tenders and contracts, and a tendency to favour short-sighted expenditure on football stadiums and other popular undertakings that are beset by corruption even more pervasive than at the national level (Moran, interviews in Peru, 2007). Perhaps a better model can be found in Chile's centralized budget allocations directed to roads and schools in mining regions, an approach that has resulted in measurably superior poverty reduction in Antofagasta (ICMM, 2009).

Within a setting of reasonable transparency and appropriate governance (both corporate governance and host governance), a rich natural resource endowment can regain the stature it was once assumed to occupy in early development textbooks, as the foundation for broad-based and lasting national development.

2.3 Not all manufacturing FDI is good for development

The evidence from the 1980s and 1990s showed that the model of imposing performance requirements on manufacturing FDI in protected national markets to compel technology transfer and promote import substitution did not work very well, if at all. International companies forced to form joint ventures with local partners held back their cutting edge technology, precisely because they feared "leakage" of production and marketing techniques. Cost/benefit analysis of plants built behind tariff walls shows that they actually subtracted from national welfare and inhibited host-country growth. Most importantly, domestic content and joint venture mandates prevented the formation closely integrated manufacturing supplier networks. As will be developed below, this is where the most dynamic contribution to host-country development can be found.

The empirical discovery that tighter controls on the operations of manufacturing TNCs hurt host economic prospects – and fewer controls on manufacturing TNCs enhance the prospects for greater value-added and more competitive backward linkages – continues to take many in the pro-poor sustainable development policy community by surprise. Enthusiasm for performance requirements led some developing country representatives (backed by NGO advisers) to insist at the Hong Kong WTO Ministerial Conference in 2005 that implementation of the Agreement on Trade-Related Investment Measures (TRIMs) – which bans domestic content and trade-balancing mandates – be pushed as far into the future as 2020. Contemporary policy advice from some quarters continues to champion use of these measures on manufacturing TNCs, as shown in the debate about revising the United States Model Bilateral Investment Treaty (Center for International Environmental Law et al., 2009; Working Group on Development and Environment in the Americas, 2008).

The evidence, however, consistently demonstrates that trade-related measures – especially domestic content requirements – inhibit the contribution of manufacturing FDI to long-term sustainable growth. The latest research from the United Nations Conference on Trade and Development (UNCTAD) on TRIMs – examining experiences in Argentina, Ethiopia, Pakistan, Philippines and Viet Nam – reiterates what earlier studies have shown, namely how counterproductive performance requirements have turned out to be (UNCTAD, 2007). The supposed exception proves the rule: the growth of Viet Nam's motorcycle parts industry came about because the fundamental economics for Honda, Suzuki, and Yamaha to find local parts suppliers were favourable, not because of the legal requirement to meet a 60 per cent domestic content. As for Viet Nam's automotive industry, the evidence casts "doubt on the merit of trade related measures in fostering an indigenous automobile industry"; whereas in Viet Nam's electronics industry, and wood, milk, cane sugar and vegetable oil processing industries, "the merits of TRIMs may have been overrated" (UNCTAD, 2007, pp. 133, 141–142).

Though trade-related measures may generally inhibit sustainable growth, it is important to note that export performance requirements may, in contrast, be beneficial. Export performance and trade-balancing requirements did play a catalytic role in encouraging international auto investors to build world-scale engine and final assembly plants in Mexico and Thailand in the late 1970s. The requirement to export stimulated international companies to turn away from building sub-scale plants to produce for protected national markets, to creating world-scale production facilities. Export performance requirements, or trade-balancing mandates that simply use trade rents to cross-subsidize a few exports from boutique plants, in contrast, do not lay the foundation for an international competitive industry. In summary, with several minor exceptions, trade-related measures inhibit the contribution of manufacturing FDI to sustainable growth.

The pro-poor sustainable development policy community – including the World Bank and regional development banks, national assistance agencies (export-import credit agencies, official political risk insurers, as well as aid agencies), and civil society NGOs – will want to endorse the TRIMs Agreement and drop efforts to change the US Model BIT in this particular area, and discourage host imposition of performance requirements on transnational manufacturing investors. As the concluding section of this article points out, such a stance is a far cry from contemporary reality.

2.4 Applying external pressure to help low-skilled workers without generating counterproductive consequences is difficult but not impossible

As noted earlier, there is abundant evidence that FDI in low-skill intensive manufacturing and assembly in poorer as well as middle-income countries can have important developmental impacts. Paul Romer chose Mauritius, when it was one of the world's poorest countries, as an example in which low-skill intensive FDI could have a transformative influence on the economy (Romer, 1992). Foreign investors fuelled a growth record that later ranked Mauritius seventh among the 15 most successful exporters of manufactured products in the world, with exports reaching more than $1.2 billion in 2008 (51 per cent of all exports), and with 413 companies employing 65,000 workers. The Dominican Republic had a per capita GDP only two-thirds as high as Mauritius when its Government started to lure FDI into manufacturing and assembly. By 2008, total zone investment exceeded $1 billion, total zone employment was 155,000, and total zone exports reached $4.5 billion (65 per cent of all exports). In Kenya, 10–15 per cent of all formal employment consists of smallholder farmers becoming "indirect exporters" of fresh vegetables and flowers via transnational corporate networks (50,000–60,000 employed directly and some 500,000 in associated activities related to cut flowers alone in 2008) (Ngige et al., 2009; Bell et al., 2007). Production of garments, footwear, toys and other such products for export can provide a channel out of rural areas, and out of the informal economy, for hundreds of thousands of workers. In Bangladesh, foreign investors and indigenous subcontractors lobbied against Muslim traditions prohibiting women from working in factories. Today, two million workers, predominantly female, are employed in Bangladesh's garment export sector, earning 25 per cent more than the country's average monthly per capita income (USAID, 2008).

Combatting sweatshop abuses in export processing zones (EPZs) and free trade zones (FTZs) is a notoriously complicated undertaking. The most successful campaigns frequently involve multiple international and local participants, including labour unions, NGOs, and independent auditors and monitors. For example, the struggle to unionize the Haynes TOS Dominicana plant – which produces fabric for T-shirts and is one of the largest textile manufacturers in the Dominican Republic's export industry – lasted from 2006 to 2008. The Workers Rights Consortium (WRC), an independent labour rights monitoring organization founded by university administrators, labour experts and student activists, launched an investigation of worker complaints in October 2006. WRC has more than 150 college and university affiliates concerned about garments bearing their collegiate logos. The AFL-CIO's Solidarity Center provided technical and legal support during the unionization drive.

After Haynes became a member of the Fair Labor Association (FLA), an NGO with socially responsible companies, universities, and civil society organizations on its Board, the FLA received a complaint (in February 2008) about non-compliance with the FLA Code of Conduct in the area of freedom of association and collective bargaining, and initiated consultations among all the stakeholders. At the end of tough but successful bargaining, Haynes and the Syndicato de Trabajadores TOS Dominicana signed their first collective agreement on August 12, 2008.

In a slightly different application of external pressures, the campaign to help workers at the Legumex fruit and vegetable processing plant in Guatemala was launched by the National Labor Committee (NLC), an NGO formed to combat sweatshop abuses with backing from organized labour.[7] The NLC worked through a local NGO, the Center for Education and Support for Local Development (CEADEL), to ensure all workers earned at least the minimum wage, were paid for overtime, were enrolled in the Guatemalan Social Security Institute, were equipped with protective gear to wear in the cutting areas, and enjoyed new bathrooms and a cafeteria with tables and chairs. On March 18, 2007, the NLC, CEADEL, the US buyer, and the plant management signed an agreement confirming these "major improvements", as characterized by the NLC.

It is by no means certain, of course, that even highly coordinated intensive campaigns will be successful. Beginning in 2008 the Russell Corporation, privately held within the Berkshire Hathaway investment group, faced pressures across a broad front because of complaints about labour practices at its Jerzees de Honduras plant. The Workers Right Consortium asserted that Russell managers had carried out a campaign of retaliation and intimidation against members of the company union Sitrajerseesh, which led to closure of the plant in January 2009. WRC insisted upon re-opening of the plant and reinstatement of the workers. Major universities – including Duke, University of Wisconsin, University of Michigan, and Georgetown University – launched a boycott of Russell. In May, 65 United States Congress members wrote to the Russell senior management expressing concern about labour practices. Despite these

[7] Harvest of Shame, http://www.nlcnet.org.

efforts, in June, 2009, Russell was placed on probation by the Fair Labor Association – a first in FLA history – for failure to follow through on a remediation plan for the workers.

In the context of campaigns such as these, it is odd – but not unusual – to discover international trade union representatives claiming that they should be the exclusive advocates for the interests of developing country workers, and denying any standing to NGOs and other civil society labour rights organizations (Larson and Hankin, 2009; Justice, 2003). It is undeniable that local unions might be able to have the closest continual contact with the plight of workers, and avoid the disadvantages that external attempts to spot-check conditions under possibly faked conditions encounter. But the depiction of independent democratically run trade unions, aiming solely to represent the best interests of their membership – as idealized in textbooks about the role of trade unions in developed countries – often differs significantly from the politically connected, extortion-focused, corrupt organizations found on the ground (USAID, Bangladesh Labor Assessment and Honduras Labor Assessment, 2009; El-Shazli, 2009).

A somewhat unexpected ally in the struggle for better treatment of workers may be found within the ranks of higher-skill transnational investors. International companies producing more sophisticated goods and services – long accustomed to following more progressive human resource policies themselves – have sometimes played a central role in reducing conflict and extending the recognition of core labour standards to export processing zones and free trade zones. In Costa Rica, the Dominican Republic and the Philippines, household names from the United States and European business communities helped broker the passage of nationwide labour laws consistent with International Labour Organization standards, and pushed for more effective enforcement of the resulting regulations on the local level, including communal disciplining of violators, in a self-interested search for "labour peace" (Moran, 2009). Companies like Intel and Siemens are simply not willing to tolerate the strife and reputational threat posed by labour abuse in low-skill plants next door. When host countries are successful in attracting middle-skill foreign investors to build plants alongside low-skill foreign investors (discussed next in the fifth analytic insight), there may be "labour institution externalities" that accompany this upgrading of the mix of investors.

With regard to appropriate wage levels, foreign investors in low-skill intensive manufacturing and assembly – like other foreign investors – almost universally offer higher levels of wages and benefits than comparable local firms. In Madagascar, for example, Razafindrakoto and Roubaud (1995) found that foreign investors in export processing zones paid 15–20 per cent more than what workers with similar qualifications received elsewhere in the economy, after holding education level, extent of professional experience, and length of tenure in the enterprise constant. The evidence from Latin America and Africa shows a similar wage premium, including in low-skilled operations (Aitken et al., 1996). Robert Lipsey (2006) goes so far as to enunciate a "universal rule" that foreign-owned firms and plants pay higher wages than domestically owned ones.

Further evidence is presented in Graham (2000), found when he double-checked to see whether such wage-premiums might be more pronounced in richer developing countries, and less evident in poorer developing countries, and discovered exactly the opposite: compensation per indigenous employee in foreign plants in the manufacturing sector is larger, as a multiple of average compensation per employee in the local manufacturing sector, in poorer countries than in the middle-income developing countries. In the latter, the ratio of foreign-paid wages to indigenous-firm wages in manufacturing was found to be 1.8; in low-income developing countries, the ratio of foreign-paid wages to indigenous-firm wages in manufacturing was 2.0, or twice as high as average compensation in the local manufacturing sector.[8]

Nevertheless, actual wage levels may still be dismayingly low, causing justifiable consternation on the part of external observers. What might be done about this? Trying to find an answer poses genuine quandaries for the pro-poor sustainable development community.

My own reading of the evidence is quite pessimistic about how to design policies to intervene in markets directly to advance the interests of workers through higher wages, without having counterproductive effects (Moran, 2002). High minimum wages and living wages not tied

8 Graham removes salaries for foreign managers and supervisors from these calculations.

to relative productivity tend to make exporters uncompetitive. Living wages calculated to support worker families of regional average size discriminate against younger, older, and single workers (this outcome is unaddressed, and simply ignored, by many pro-labour organizations) (ILO, 2008; OECD, 2009). High minimum wages act as a disincentive for hiring of entry-level and other lesser-skilled workers. The most effective public policy to augment the earnings of low-skilled workers – besides skill-training to improve their productivity – is an earned income tax credit or other form of negative income tax, which is quite expensive for any government to implement.

One idea that may hold promise is the following: pressure from CSR and NGO groups on international companies that produce or sell highly branded or collegiate-logo products to ensure that lowest level workers receive what might be called a "decent wage", say prevailing wage per skill level plus a premium of 20 per cent. But any such decent-wage system must be designed to transfer oligopoly rents from the international marketer or retailer (or from consumers) to the workers; it cannot simply insist that production companies and their subcontractors pay above-market wages and absorb the costs themselves. A direct transfer mechanism from consumers, or from branded oligopolists, to production-line workers is a feature of many "fair trade" arrangements: in Kenya's flower industry, companies that want to qualify for the Fair Trade label promise to assign 8 per cent of the free-on-board price for flowers to education and health initiatives, as determined by worker-management committees. Wages and benefits for each worker depend upon experience and performance. However, in the case of one of the largest international flower and fresh vegetable exporters, Vegpro of Canada these ratios are 15–20 per cent above the sector minimum wage for entry level workers and 30–40 per cent higher for more experienced workers (Bell et al., 2007).

2.5 Using FDI to diversify production (and exports) and move from lower-skilled to higher-skilled FDI operations is the new frontier for development policy

Although popular preoccupation about globalization and worker issues in the developing world focuses on low-wage sweatshop-type concerns, the data show clearly that by far the majority of manufacturing

FDI in developing countries flows to more advanced industrial sectors, rather than to garment, footwear, and other lowest-skilled operations, and the weighting toward more skill-intensive investor operations is speeding up over time.

As table 1 shows, the flow of manufacturing FDI to medium-skilled activities such as transportation equipment, chemicals, rubber, plastic products, industrial machinery, electronics and electrical assemblies is nearly 10 times greater each year than the flow to low-skilled, labour-intensive operations, and has been speeding up over time. The ratio between higher and lower skill-intensive activities was approximately five times larger in the period 1989–1991, but almost 10 times larger in the period 2004–2006.

If the stock of manufacturing FDI is substituted for the flow, similar results hold true: a ratio of seven to one in 1990, a ratio of 10 to one in 2006 (these ratios are probably understated, moreover, since data on FDI stocks typically do not provide accurate information on reinvested earnings and allowances for accelerated depreciation which are concentrated in the more capital-intensive higher-skilled FDI operations).

Table 1. Manufacturing MNC operations in developing countries

	FDI Flows (millions of dollars)			FDI Stocks (millions of dollars)		
	1989-1991 (annual average)	1999-2000 (annual average)	2004-2006 (annual average)	1990	1999	2006
Lowest-Skilled Sectors	$2,860	$3,100	$9,526	$19,885	$46,864	$65,134
Higher-Skilled Sectors	$13,270	$52,800	$92,818	$134,686	$505,928	$653,277

Source: UNCTAD, 2009

For a complete breakdown by sector, see annex I (FDI flows) and annex II (FDI stocks) from the UNCTAD database in Moran (forthcoming).

This points to an important question: how great are the benefits that come from the liberalization of trade and investment, as host countries move up the ladder from low-skilled to higher-skilled FDI activities? The standard models that dominate economic calculations today far underestimate the potential benefits from the continuous opening of developing countries to trade-and-FDI simultaneously. This is because such models implicitly assume that all the goods and services that can be produced in a given economy are already “known”, and the gains from trade-and-FDI liberalization come simply from letting firms and workers do more efficiently (what they are already capable of doing Romer, 1994).

However, some like Hausmann and Rodrik (2009) argue that this assumption is obviously inaccurate. Dynamic comparative advantage means that entrepreneurs do not already “know” all the production possibilities within a given economy. The key to development is to identify new and more sophisticated activities, and bring them into being. Here, FDI can play a key role, carrying a host economy with one leap to the cutting edge of technology and management in some novel industry. When Texas Instruments brings advanced electronics for the first time into the Philippines, or Volkswagen brings high performance auto parts for the first time into Slovakia, or Seagate brings disk drive manufacture for the first time into Malaysia, four hitherto under-appreciated accomplishments are being realized simultaneously. Texas Instruments, Volkswagen and Seagate are helping the host-country to move up the ladder from low-skilled activities to higher-skilled activities; they are helping to diversify exports; they are placing the host along the frontier of best practices in the international industry; and they are hooking the host into every improvement and advance that takes place in the industry anywhere, on a near real-time basis. As shown by Romer, the resulting benefits from foreign investment are of the order of 10 to 20 times greater than what models estimate when the host simply does more of what it already does, more efficiently!

Still, using FDI to help transform the production and export base of a country does not come about easily. As Hausmann and Rodrik point out, there are important market failures that inhibit this process from taking place naturally when hosts simply lower barriers to trade and FDI. These market failures include coordination externalities (hosts must ensure that there is reliable infrastructure and access to specific-skilled healthy workers and technicians), information asymmetries (hosts must prepare customized proposals for first-time investors), and appropriation problems (risk-averse TNCs often prefer follow-the-leader rather than first-mover investment). There are environmental standards that have to be set, and enforced, to cover electronics and auto parts plants, no less than mines and refineries.

To overcome these market failures – and allow the host to upgrade and diversify its economic activities and export base – requires up-front expenditure and sustained effort, in addition to the liberalization of trade and investment. It has become increasingly clear that paying international consultants to conduct yet another drive-by policy review, handing the results over to host authorities with an impressive-looking cover, has very marginal utility. What is needed is support from the pro-poor sustainable development policy community to sustain effective investment promotion agencies (IPAs), prepare customized FDI proposals for potential investors, create public–private programmes for healthcare and vocational training, provide on-call assistance for infrastructure, and identify and motivate indigenous programme-and-policy champions. This is the new frontier where multilateral banks (including the World Bank group and regional development banks), national assistance agencies, and international civil society can cooperate to underwrite entirely new economic activities, while creating cutting-edge industrial zones and science parks. As the concluding section points out below, the performance of one vital segment of this grouping – national assistance agencies – is spotty in the extreme, and sometimes explicitly forbidden.

Such an endeavour is all the more valuable when undertaken in conjunction with host-country efforts to deepen backward linkages from foreign investors to local firms and develop indigenous supplier networks, considered in the next analytic insight.

2.6 Enlarging backward linkages from FDI and expanding local supply-chains is the biggest contemporary challenge

Development strategists, dismayed by how counterproductive the results are from imposing performance on TNCs, can take comfort in the refreshing discovery of spillovers and externalities from TNCs that are not burdened with domestic content and joint venture mandates.

To be sure, "technology transfer" in a horizontal direction from TNCs is somewhat of an oxymoron. Manufacturing TNCs try assiduously to prevent the leakage of technology, production techniques, and trained personnel to other firms that might become rivals. Luckily – from a developmental point of view – they are not always successful, as workers and managers carry on-the-job experience around the industry. Contemporary survey data from Eastern Europe highlight two additional channels through which local firms watch and copy foreign practices: 25 per cent of the managers of Czech firms and 15 per cent of the managers of Latvian firms indicated that they came to understand new technologies by observing foreign firms enter their industry; 12 per cent of the Czech managers and 9 per cent of the Latvian managers discovered new marketing techniques and sales outlets by watching the foreigners' operations (Javorcik, et al., 2005).

In the vertical direction, the dynamics of technology transfer are very different. Manufacturing TNCs find it in their interest to identify and nurture local suppliers. Survey data from Eastern Europe record multiple forms of direct assistance between foreign investors and new suppliers: assistance with setting up production lines, help with management strategy and financial planning, advance payment and other kinds of financing, coaching in quality control, and introduction to export markets (an export externality). In Indonesia, Blalock and Gertler (2009) found that foreign TNCs not only helped indigenous firms with production techniques, quality control, and management but likewise introduced successful Indonesian suppliers to sister affiliates of the TNCs around South-East Asia.

The development of a local supplier base happens neither quickly nor automatically. Time is required for TNCs to develop backward linkages. Giroud and Mirza (2006) found that the extent of local input linkages in Cambodia, Malaysia, Thailand, and Viet Nam varied directly as a function of how long the local foreign affiliate has been in the country, while Belderbos et al. (2000) made a similar finding for Japanese TNCs. Local firms also need business-friendly local conditions, skilled workers, and access to imported intermediates in order to prosper, and sharpen their skills. If the gap in sophistication between foreign investors and indigenous companies is too large, few linkages result. In Mexico, Kokko (1994) found that spillovers between foreign affiliates and local firms varies as a function of the productivity difference between the two.[9] In the Uruguayan manufacturing sector, Kokko et al. (1996) observed the same phenomenon.

To spur the process along, some countries have instituted vendor development programmes (see UNCTAD, 2001). Singapore paid a part of the salary of FDI managers who would act as talent scouts among local enterprises, and provided loans to indigenous companies for equipment recommended by foreign buyers. Malaysia and Thailand have set up industrial parks alongside their country's large EPZs, with registries of local firms in those parks. Even in cases of success, the spread of supplier networks always appears "too slow" and "too limited": El Salvador aspires to the backward linkages of the Dominican Republic; the Dominican Republic aspires to the backward linkages of Costa Rica; Costa Rica aspires to the backward linkages of pre-crisis Ireland; as part of its economic recovery, Ireland aspires to the backward linkages of Germany. Nonetheless, the logical conclusion for the pro-poor sustainable development policy community – after supporting infrastructure development, public-private partnerships in vocational skill-building institutions, and on-the-job and night training classes (as discussed above in the fifth analytic insight) – is to support a business-friendly local economic environment, backed by an increasingly open trade regime, in order to promote backward linkages and supplier networks.

2.7 The effort to cap and roll-back tax breaks and other giveaways to transnational investors must be an international initiative

The preceding two analytic insights have recommended that multilateral and national donors, backed by international civil society, provide support to help would-be hosts to improve infrastructure, vocational training, and investment promotion to attract more sophisticated foreign investors to first-class economic zones and industrial parks, and expand local supplier networks. To the extent possible, the not inconsequential financial expenditures associated with these endeavours should be separated from the mindless

[9] The importance of the skill-difference between foreign investors and potential suppliers is different from the argument that FDI cannot raise the productivity of a host economy until a threshold human resource level has been achieved.

competition in tax breaks and give-aways that now besets the scramble for investment around the world.

There is now solid econometric analysis to demonstrate that there is growing competition among developing country FDI sites, and between developing country FDI sites and developed country FDI sites, to secure international investment. John Mutti (2010) finds that the independent influence of taxes on the location of production is statistically significant and growing over time, and that the impact of tax competition is particularly intense between locations where much of the output is destined for export. Case study evidence reveals that TNCs typically identify three or four roughly comparable investment sites, and then unleash their negotiators to bring back the biggest tax breaks as a "tiebreaker".

This competition in tax breaks has all the pernicious characteristics of the prisoner's dilemma. No participant can refuse to give in to the demand for tax breaks on his own without losing out entirely. What is needed is an international cooperative endeavour to limit and then roll-back such self-destructive behaviour. The challenge for achieving progress in such an undertaking is that states – and even municipalities – must be brought under common control, Sao Paulo no less than Alabama, Brno no less than the "Eastern Corridor" of Malaysia.

3. Implications for the *Pro-Poor Sustainable Development* Community

FDI – in all its forms – is at best only a modest force in raising living standards and enhancing economic and social welfare around the world. But the evidence introduced here shows that the positive benefits from mainstream FDI activities can be much greater than customarily portrayed. These positive benefits cannot be assumed to arrive – and negative damages to be avoided – simply by allowing market forces to operate unchecked. Instead an array of outside interventions, outside pressures and outside support mechanisms are needed to optimize the contributions that FDI can make to development.

This article has tried to identify what the most important of these outside interventions, outside pressures, outside support mechanisms are, and to argue that these should become a principal focus for the pro-poor sustainable development community, including multilateral lenders, national assistance agencies (including export-import banks and political risk insurers, as well as aid agencies), international labour and civil society groups, and CSR advocates. What follows are prescriptive recommendations for each constituent group of the pro-poor sustainable development community.

3.1 The World Bank Group and other multilateral financial institutions

As the financial crisis fades, the World Bank Group and other multilateral financial institutions will once again face the perennial question of whether they should still devote their scarce resources to middle-income countries, especially in the midst of a revival of strong FDI flows. The evidence introduced here demonstrates that the list of market malfunctions indeed extends to middle-income developing countries, especially extractive industry-rich developing countries, and manufacturing-base developing countries struggling to upgrade and diversify their exports.

Despite concerns, World Bank Group and regional development banks should reshape their approach to helping integrate foreign investment into development strategy. With regard to natural resources FDI, the EITI + + agenda is well on-track, although the initiative must still be transformed into concrete plans with monitored results, and shaped to extend the umbrella of transparency and non-corruption to investors from all countries. The most significant expansion of the EITI + + approach, as recommended here, involves additional help for developing country authorities in negotiating oil and mining investment agreements.

With regard to FDI in manufacturing and assembly, much work still needs to be done on the nuts and bolts of investment promotion among low-income countries. Survey data from the World Bank Advisory Services (2009) show that many low-income country IPAs fail even to answer telephone calls and emails from prospective investors. A majority of those that do seem unable to provide information or advice to an investor beyond what already appears on the IPA website. IPA websites themselves often have incorrect or incomplete telephone numbers and email addresses. Other IPAs, however, have been able to show dramatic improvement – among the list in 2008 were Botswana, Ghana, Honduras, Romania and Sri Lanka.

Turning to the challenge of helping developing countries move up the ladder from lowest-skilled operations to more sophisticated FDI activities, the day of simply handing over consultant reports on policy reform, perhaps supplementing the reports with training seminars on investment attraction, must give way to coherent action plans to attract higher skilled investors and expand the domestic supplier base. The ingredients include customized investment promotion, backed by resources for FDI-associated infrastructure and vocational training, with sustained on-the-ground technical support, carefully linked into local policy champions and advocates.

Finally, the World Bank Group and regional development banks must screen out support for FDI projects that rely upon trade protection to survive, as considered in more detail next.

3.2 National assistance agencies, including aid agencies, export-import banks, and political risk insurance agencies

Like the multilateral financial institutions, national assistance agencies can play an integral role in enhancing the contribution of transnational investment to broad-based sustainable development. In some areas, current approaches must be sustained, such as – in the case of the United States – the support by USAID for Solidarity Center programmes to promote labour rights (including labour rights for FDI workers), the Millennium Challenge Corporation's grants for major infrastructure improvements, or the provision of political risk coverage for FDI in the poorest and most difficult developing economies by the Overseas Private Investment Corporation (OPIC).

Some developed countries have played a catalytic role in helping developing countries to integrate FDI into their development strategy. Germany took an equity stake in the Lesotho National Development Corporation, a central player in the country's dynamic FDI-led export drive, for example, to help get it launched. The record of the United States in this regard has been more mixed. USAID has occasionally played an equally vital role as in helping to renovate Costa Rica's Investment Promotion Agency, but has often backed away from such endeavours. The Millennium Challenge Corporation is struggling to improve its procedures in this arena, including providing help for threshold countries to design compacts around the goal of eliminating bottlenecks and facilitating both international and local private sector investment.

In two important areas, fundamental changes are required. First, the operating policies of some official support programmes must be tightened. Seventeen of the 20 major national political risk guarantee agencies do not screen out FDI projects that require significant host country protection to survive (Center for Global Development, 2009). The official political risk insurers of Canada, France, Germany, Italy, Japan and the United Kingdom, for example, assess the likely profitability of FDI applicants, but not whether their contribution to host economic welfare is positive. Since protected plants are often highly profitable, they pass the test for insurance support. In fact, as discussed in O'Sullivan (2005), OPIC has gone so far as to provide political risk insurance against removal of protection, and paid the claim for "breach of contract" when the host country was audacious enough to undertake domestic reform!

Second – and at the same time as the first change – other official support programmes must be loosened. Seventeen of 20 official political risk insurance agencies in the developed world do not provide coverage for projects with the most powerful development impact, including low-skill labour-intensive FDI exports in least developed countries, and middle-skilled FDI exports from more advanced developing countries (Center for Global Development, 2009). Two countries (Austria and the United States) have self-imposed restrictions that prevent them from providing coverage to foreign investment projects that might in any way compete with home country firms.

Once again the United States-based OPIC is the poster child of counterproductive restrictions. Originally launched with an explicit "development mission", OPIC has actually been placed under increasingly heavy Congressional restrictions over the past several decades. OPIC is prohibited from providing political risk insurance or financial guarantees to many labour-intensive projects; it is also precluded from supporting textile or garment projects, or agricultural processing projects if the crops involved are "in surplus" in the United States. Concern about "sensitive sectors" in the United States economy has kept OPIC from offering insurance to United States investors interested in setting up EPZs anywhere abroad. OPIC refuses to support any outward investment projects if there might be even a single job lost, even if net job creation within the United States clearly is positive.

3.3 International labour and civil society groups

The past has seen a vibrant critique of the participation of self-appointed, non-representative NGOs in the affairs of international investors. But the evidence summarized here shows that Transparency International, Global Witness, Publish What You Pay, Revenue Watch Institute and other international civil society groups – and their local counterparts – have a vital role to play in providing public goods and helping with setting and monitoring international standards. This role is already well established in the activities associated with supporting EITI and related anti-corruption efforts, but the preceding analysis shows that the need for external pressures covers vital aspects of the operations of manufacturing TNCs as well.

In order to help enhance the contribution of FDI to broad-based sustainable social and economic development, many participants in the pro-poor sustainable development community will have to re-examine some of basic tenets of their past recommendations.

Popular insistence on higher minimum wages or generous living wages for workers is likely to be counterproductive for reasons outlined earlier (leaving plants uncompetitive, or, even if not, discriminating against younger, older, and single workers). Foreign investors and their subcontractors will need some flexibility to alter the level of employment in response to fluctuations in external markets. The challenge is to combine productivity-based wages, labour market flexibility, and broadly acceptable conditions of work for low-skilled workers. As a special case, low-skilled employees working for suppliers to highly branded retailers (including collegiate retailers) should be able to garner premium earnings, transmitted to them from oligopoly profits and consumer pockets.

In order to upgrade the production base and diversity exports, international labour and civil society groups will want to acquaint themselves with the negative consequences of imposing performance requirements (joint venture and domestic content requirements) on TNCs – as documented here – leading them to abandon antagonism toward the TRIMS agreement and pare back their opposition to control of performance requirements in the United States Model BIT (Center for Environmental Law, et al., 2009).

Complementing this, international labour and civil society groups will want to recognize the importance of business-friendly treatment of local firms as an essential ingredient in indigenous supply-chain development.

As participants in "campaigns" to combat denial of worker rights and abusive treatment of labour, international labour and civil society groups have overlapping and mutually supportive parts to play. The attempt by any one group to monopolize the support for international workers and disparage the efforts of others undermines the strength of those who want to help workers in the developing world.

3.4 CSR advocates

It is widely recognized that the concept of CSR is very broad and means different things to different constituencies.[10] With regard to socially responsible transnational corporate investment, the umbrella principles that should be followed by companies are embodied in the 10 fundamental principles in the UN Global Compact, categorized and enumerated below:

Human Rights

- Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and

[10] Jessica Freireich and Katherine Fulton (2009) identify a long list of distinctions: Socially Responsible Investing, Social Investing, Mission-Driven Investing, Sustainable and Responsible Investing, Blended Value, Values Based Investing, Mission-Related Investing, Ethical Investing, Responsible Investing, Impact Investing, Programme Related Investing, Triple Bottom Line Investing, Environmental, Social, and Governance Investing.

- Principle 2: make sure that they are not complicit in human rights abuses.

Labour Standards

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

Environment

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

Anti-Corruption

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

Besides acknowledging these standards, socially responsible international companies must follow up with internal systems – along with training for employees and managers – to promote compliance and report results. While reporting systems vary widely, the most widely recognized template is embodied in the Global Reporting Initiative (GRI)[11].

Importantly, the argument that emerges from the analysis here is that a much more pro-active role from international investors is

[11] Global Reporting Initiative, http://www.globalreporting.org/ (accessed July 1, 2009).

needed with regard to their mainstream operations, well beyond mere "complying" and "reporting".

For example, to deal with "resource curse" issues, the GRI indicates that international investors should "report the percentage of total number of management and non-management employees who have received anti-corruption training", and "provide a description of significant impacts of activities, products, and services on biodiversity in protected areas and areas of high biodiversity value outside protected areas". By contrast, the recommendation presented in section IIB (above) is preferred because it is much more specific and assertive. Socially responsible international resource companies should use their influence when they negotiate new contracts or make follow-on investments to bring the countries where their wells and mines are located into the EITI + + regime. Socially responsible international resource investors should join together to create industry-wide standards to preserve the environment, address the needs of indigenous peoples, and incorporate full-life cycle community planning into their projects, while simultaneously supporting capacity-building for local and national monitors. Socially responsible international resource investors – to their own benefit, as argued earlier – should endorse and push for transparent of revenue streams on an company-by-company basis (thereby exposing non-OECD investors to the same scrutiny as OECD investors), rather than insisting on aggregate-only reporting of revenue stream (which allows non-OECD investors to avoid close scrutiny).

In order to promote backward linkages, the GRI recommends a report on "how much do you buy locally". But the analysis presented in section IIE (above) identifies much more targeted actions:

- Has the socially responsible investor designated a manager to be a "talent scout" to search out potential indigenous suppliers (or liaise with local vendor development agencies)?
- Does the socially responsible investor take measures to provide production advice, managerial advice, and advance purchase orders to potential indigenous suppliers (a teaching externality)?
- Does the socially responsible investor have procedures to "qualify" and "certify" potential indigenous suppliers (a labelling externality)?

- And, does the socially responsible investor have a programme through which qualified indigenous suppliers are introduced to sister affiliates in the region (an export externality)?

With regard to influencing the environment for business, the GRI protocol suggests that TNCs report on their public policy positions, and their participation in public policy development and lobbying (as recommended in OECD guidelines). CSR pressure of the kind recommended in section IID (above) would push TNCs to support labour institution externalities, such as ensuring that all members of the business associations they belong to (no matter what skill-level their operations) operate with common and mutually acceptable human resource standards, albeit different wage levels.

One could examine other industry-wide or specific company codes of conduct and – as attempted with the long list of reporting protocols in the GRI – try to translate the findings reported here about how to optimize the contribution of FDI to development into clear actions on the part of international investors. The common justification for such actions is that the strongest contribution FDI can make to host-country growth and welfare comes from well-structured, well-run, environmentally sound mainstream operations of TNCs.

Finally, the findings introduced here should not undercut the efforts of those in the pro-poor sustainable development group who simply want to pressure TNCs to "give back" more to the communities where they operate – the most frequent outcomes are pressure to set up community-based social projects directly or to provide aid to local organizations and initiatives. But the evidence shows that the principal benefits from foreign investors come from ingredients their mainstream operations inject into the host economy directly, not from the accompanying philanthropy (no matter how welcome). The new CSR agenda proposed here insists that direct social or poverty-reduction efforts – even large ones! – should not substitute for an insistence that mainstream TNC operations be run in an open, competitive, well-structured manner. Corporate charity surely has its place, but the pro-poor sustainable development policy community will want to begin to refocus on the larger – and in many ways more important – set of targets sketched out here.

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The international financial crisis and transnational corporation strategy

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As is well-known to readers of this journal, foreign direct investment (FDI) is undertaken by transnational corporations (TNCs). In many ways FDI is not a financial investment decision, rather it is a micro-level, firm-driven, strategy decision. Thus FDI and TNC strategy need to be carefully distinguished from financial (portfolio) investment decisions which are country-level, macroeconomic, decisions. This distinction between FDI and portfolio investment has eluded many commentators on the international financial crisis. For example, although large banks and financial institutions are types of TNCs, their firm-level strategic FDI decisions need to be distinguished from country-level macroeconomic trade and financial imbalances. In this paper, we attempt to work through the logic of this distinction between FDI and portfolio investment to analyse the international financial crisis.

1. Introduction

We need to distinguish between macro, country-level, portfolio (financial) investment, and micro foreign direct investment (FDI) where the latter is the result of firm-level strategies. Adopting this distinction, transnational corporations (TNCs) had a negligible direct impact on the international financial crisis of 2008. TNCs such as General Motors and the international financial institutions are publicly regarded as drivers of the financial crisis, but this can be better explained by analysis of macroeconomic policy and the reasons for a global imbalance of foreign exchange reserves and financial assets, in particular between China and the United States. In other words, it was misalignment of financial portfolio investment that caused the global crisis, not FDI undertaken by TNCs. Still, the financial crisis has had substantial impacts on TNC organization and strategy: most visibly, TNCs have been adversely affected by the financial crisis, as evidenced by substantially decreased flows of FDI. Perhaps more interesting, however, are the long-term effects of the financial crisis on TNC strategy, which is our focus here.

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TNCs have been affected by the international financial crisis of 2008, especially in terms of changes in government policies. Government policies put in place to mitigate the macroeconomic impact of the crisis have strong protectionist elements (in the form of subsidies such as bail-outs). The impact of such strong government support, in a strategic sense, is to make TNCs behave like national champions. However, the extent of government support for TNCs varies widely by region. In general, the new TNCs from emerging economies (in particular China) serve as agents for their home government strategy, and act as instruments to improve national competitiveness. In contrast, Western TNCs from North America and Europe are less engaged with their home governments, and presently behave only as indirect national champions.

This article explores the murky waters linking government policy and the strategic positioning of TNCs. Traditionally, this linkage has been examined at microeconomic level, usually with industry-level analysis of the ways in which home government support for specific sectors can lead to an improvement in the international competitiveness of leading firms in each sector. For example, Porter (1990) examines the international competitiveness of nations based upon the exports and outward FDI of leading firms, using a broadly sectoral level of analysis. In contrast to this type of research, today we need new analysis to understand the ways in which macroeconomic policy initiatives (in the form of bail-outs and other subsidies) have led to changes in the strategies of TNCs.

The principal finding of this article is that macroeconomic imbalances in the form of a large trade surplus and huge foreign exchange reserves in Asia, in particular in China, will lead to the continued rapid growth of Asian state-owned TNCs. In contrast, Western TNCs are likely to expand at a much slower rate as their competitive advantages are firm-specific and only indirectly linked to government support. However, the asymmetric macroeconomic impact of the crisis needs to be analysed within the microeconomic framework of TNC strategy. Viewed in this light, it is apparent that Western TNCs can realize the benefits of international diversification, especially if they focus upon entry to the markets of North America and Europe. In contrast, Chinese TNCs are likely to go through a stage of FDI in the United States and Africa (for market seeking and natural resource seeking reasons, respectively) but will not benefit as much from international diversification.

2. TNCs as Networks

The world financial crisis of 2008 was characterized by a breakdown in the banking systems of the United States and European countries. In this article, the focus is upon analysis of the strategies of TNCs as they *respond* to the world financial crisis, and in the way they interact with governments. We examine TNC strategy in the new financial environment. We link this to an analysis of the extent to which TNCs now use their worldwide networks of subsidiaries as a source of competitive advantage and realize the benefits of international diversification.

For purposes of understanding TNC strategy, it is useful to review some theoretical framework. The traditional model of TNCs examines the extent to which country-specific advantages (CSAs) and firm-specific advantages (FSAs) interact to explain patterns of FDI and performance. This CSA/FSA framework was first developed in Rugman (1981), and refined by Rugman and Verbeke (1992), and serves as a basic framework used to analyse international business strategy in Rugman (2009). Within this framework, TNCs can be identified as either market seekers, natural resource seekers, efficiency seekers or asset seekers (Dunning, 1981). The goals of a TNC will determine the way that locational factors – or CSAs – in the home and host nations are matched with firm-level factors including advantages stemming from ownership and potential gains from internalizing sections of the supply chain.

In traditional frameworks, TNCs are recognized as developing FSAs based upon an internal knowledge advantage. Early internalization theory by Buckley and Casson (1976), Rugman (1981) and Hennart (1982) used transaction cost analysis to demonstrate that FSAs may be created from the ability of the TNC to exchange intermediate products across its internal network. These FSAs may be called non-location-bound FSAs, because the benefits of internalized processes can be captured by the entire network of the TNC, regardless of location (Rugman and Verbeke, 1992). In these early analyses, the structure of the TNC was assumed to be a traditional, centralized M-form organization, consisting of a single parent controlling a hierarchy of subsidiaries (Williamson, 1975).

It was only with the development of the economic integration and national responsiveness framework popularized by Bartlett and Goshal (1989) that the role of subsidiaries in creating FSAs became of interest. In their re-statement of the integration/responsiveness matrix, Rugman and Verbeke (1992) recognize that FSAs developed by subsidiaries in response to national conditions are unique to the location of that subsidiary, and thus may be considered location-bound FSAs. Subsequently, there has been considerable literature examining the nature, extent and rationale for such subsidiary initiatives; this literature is summarized in Rugman and Verbeke (2001), Birkinshaw (2002) and Birkinshaw and Pedersen (2009).

Scholars in management, using theories of organization behaviour and business policy have attempted to define and assess the nature and extent of subsidiary capabilities and initiatives (see e.g. Birkenshaw and Pedersen, 2009). Virtually all of this research analyses the TNC as a network, in which subsidiaries interact with each other and the parent firm as network actors. Under the network model, it is conceptually possible that location-bound FSAs can be converted into non-location-bound FSAs. For example, the best practice of a subsidiary can be generalized and applied to the entire network of the TNC. There may also be ways in which subsidiaries develop complementary assets such that their recombination can generate new non-location-bound FSAs (Verbeke, 2009).

The problem with the network approach to TNCs is that the empirical evidence suggests that the parent firm rarely concedes strategic decision-making ability to its subsidiaries. In other words, most TNCs remain centralized, hierarchical M-form organizations: studies have shown that most large United States TNCs were centralized up to the 1990s, and it is well known that Japanese TNCs tend to be organized as centralized hierarchies (Westney, 2001). While a few European TNCs may appear to pursue strategies of national responsiveness, these are often the result of a policy of mergers and acquisitions in which firms that are taken over are initially left alone to continue with their operations in countries unfamiliar to the purchaser. In general, European TNCs also do not have a strategy to foster the spread of non-location-bound FSAs across the firm. On the whole, TNCs from Japan, the United States, and Europe do not function purely as networks in the meaning given in management literature.

Furthermore, the assumption that firms behave as networks is even less valid for emerging economy firms; over the last ten years, some 90 TNCs from emerging markets have entered lists of the world's top 500 firms. Analysis of the firms from China, Republic of Korea, Singapore and other Asian countries (including India) shows clearly that they are highly hierarchical and centralized in their strategic decision-making (Rugman and Doh, 2008). Additionally, TNCs from Brazil and Russia are concentrated in the natural resource sectors, which by their nature are project-specific and tightly controlled through centralized financing, budgets and marketing.

In summary, it is apparent that the great majority of the world's 500 largest firms retain their traditional focus upon centralized decision-making within hierarchical organizational structures. However, it should be noted that emerging economy firms display a much greater degree of centralization than their Western counterparts, for which some network-based strategies such as national responsiveness may still be applicable.

The drivers toward centralized budgeting and company-wide strategy have been reinforced by the challenges presented by the world financial crisis of 2008. Additionally, national governments are increasingly interacting with the top management teams of parent firms in allocating state funds to revive faltering financial institutions and manufacturing firms. This revival of country-specific advantages at home, in the form of financial subsidies, reinforces tendencies toward centralized hierarchy, further challenging the model of TNC network-based strategies. As will be developed further below, ownership and control of the parent firm is leading to alliances with home country governments and a revival of the triad of rivalry between TNCs from North America, Europe and Asia. This will reinforce the regional (triad-based) nature of TNC activity and strategy, explored further in Rugman and Verbeke (2004).

3. TNCs and International Diversification

A neglected but important aspect of TNCs is that they engage in real asset international diversification. Indeed, a TNC is defined as a business with affiliates (subsidiaries) in more than one country. As first applied to TNCs in Rugman (1976, 1979), the principles of international diversification suggest that TNCs can partially offset idiosyncratic country-specific business cycles through their operations across borders. While a domestic company is exposed to country-specific risks such as worsening domestic economic conditions, political instability and legal threats or environmental disruption, TNCs can mitigate the cost of these risks by holding assets in many countries, each with a unique set of uncorrelated country-specific risks. Thus, in effect, TNCs are bundles of real assets offering a more stable stream of sales and revenues over time when compared to purely domestic firms of similar size and in similar industries. In the recent context of global financial crisis, which has affected all countries to a different extent and in different ways, the principles of international diversification indicate that TNCs should be generally less affected by the financial crisis than domestic firms.

Following the same logic, one might expect TNCs to maximize the possible benefits of international diversification by investing in a truly global network of assets. By investing in all regions of the globe, firms could mitigate risks that are unique to a particular region, but shared by many countries in that region. Interestingly, the opposite seems to be the case. Truly global diversification of TNC assets is not evident; unlike the globally integrated financial markets, the real asset (goods) markets in which TNCs operate are not perfectly integrated. Indeed, recent research shows that TNCs operate mainly within the broad region of their home triad market (Rugman and Verbeke, 2004)

The data indicate clearly that the world's largest firms are operating on a regional rather than global basis. Though the reasons for this are complex, the global financial crisis reveals an advantage of regionalization for many TNCs: the regional nature of business means that many TNCs have been partially insulated from the global financial crisis. More specifically, the United States-led collapse of financial institutions has had less impact on European and Asian TNCs which average over 75% of their sales in their home regions. By focusing on regional real asset international diversification and avoiding global interdependence, the financial crisis was to some degree isolated to

FDI flows in its region of origin; in other words, the regional nature of FDI flows had a stabilizing effect on the world financial crisis. If so, then real goods actors such as TNCs may generally benefit from such regionalization, and might be advised to continue to ignore globalization rhetoric and, instead, focus on a strategy of deeper home region-based integration and international real asset diversification.

4. TNCs and Government Policy

Government policy in response to the financial crisis has had a profound impact on the ways that governments and TNCs interact. Broadly, government actions such as bail-outs and other subsidies have strengthened the link between TNCs and their home country governments, further pushing these firms toward centralized, hierarchical organization that are treated as national champions. The foregoing analysis yields new insight into the changing nature of the bargaining relationship between TNCs and governments.

In his analysis of *The Competitive Advantage of Nations*, Porter (1990) demonstrates that home governments often view domestically headquartered TNCs as national champions. Under this view, a TNC's competitiveness generates national competitive advantage for the home country, which is, in turn, transmitted as influence throughout the world. This notion builds upon the earlier analysis of the bargaining between TNCs and governments by Ray Vernon (1971), in which he demonstrates the multinational spread of United States technological advantages through the worldwide networks of United States TNCs. In both approaches United States TNCs are viewed as national champions – they are the commercial instruments for the extension of United States economic hegemony. As such, the relationship between TNCs and their home country government can become a critical aspect of a firm's competitive advantage; as national champions, the success of a firm can become linked to the success and strength of its home country government support.

A critical aspect in the concept of national champions is that TNCs behave to some extent as centralized and hierarchical institutions in which the head office controls a network of subsidiaries. Without centralized control, the belief that TNCs can operate as commercial instruments of their home country economy falls apart. Interestingly, the world financial crisis may have the effect of pushing TNCs back toward hierarchical control; indeed, the crisis has served to reinforce home country dominance over the organization of TNCs in a variety of ways. For example, the large bail-outs of domestic firms in the United States banking, auto, and related sectors have reinforced the pre-eminent role of the head office over the entire firm. Additionally, negotiations between TNCs and host country governments over bail-outs and new regulations have been conducted with the home country head office rather than with subsidiary management, further eroding the autonomy of host country subsidiaries. The perceived dominance of the centralized, home country office is implicit in the coordination of international macroeconomic policy by the G20 members, in which TNCs were treated explicitly as players in their respective home country economic policies.

As TNCs trend toward centralized control, TNC strategies can be expected to shift accordingly, away from those strategies that rely on the benefits of network organization. In particular, the decentralized national responsiveness strategies for TNCs advocated by Bartlett and Ghoshal (1989) become obsolete as TNCs revert to their role as national champions, as was the case in the 1970s and 1980s. In other words, as home governments increasingly treat TNCs as instruments of their own economic policy, firms in turn rely increasingly on bargaining for government support as a source of competitive advantage. This reliance drives the firm toward a central hierarchy while strengthening the link between that firm and its home country government.

Though the drivers toward centralization and close government ties discussed above are primarily present among Western economies, the growing trend toward national champion TNCs is not limited to Western firms. In fact, the increasing prominence of large TNCs from China and other emerging economies has created international tensions, going even further to reinforce this role. In the realm of international political economy, the most visible and important tension exists between the United States and China: the huge financial surplus arising from China's balance of trade with the United States continues to be reinvested in the United States. Within this macroeconomic environment Chinese TNCs – many of which are state-owned – operate as direct champions of Chinese international economic policy. In this regard, China is not alone; many other Asian and emerging TNCs are treated by their home governments as instruments of international economic policy. Taken together, the rise of Chinese and other Asian TNCs, along with the home country and home government bargaining of Western TNCs, has led to a scenario in which TNCs have increasingly become national champions of their home governments.

An important distinction should be noted, however, between the trend from emerging market TNCs – exemplified by Chinese firms – and the trend from Western TNCs, as exemplified in the United States. Unlike their Chinese counterparts, United States TNCs are still relying primarily on efficiency-based strategies of competitive advantage, in which government support plays an indirect or secondary role. In other words, while the link between United States TNCs and United States international economic policy has strengthened to some extent, it remains at best tenuous and incidental, especially in comparison to the more directed and focused government support by China for their own TNCs. Thus there is a type of rivalry between United States and Chinese TNCs that may be somewhat indicative of larger global trends between Western TNCs and those from developing markets: United States firms must continue to rely on developing efficiency based competitive advantages independently, while Chinese TNCs will rely on the benefits they enjoy as national champions strongly supported by the Chinese government.

As an offset to the asymmetric level of government support, the benefits of international diversification apply more strongly to United States TNCs than to their Chinese counterparts. Critically, United States TNCs have a 50-year lead in establishing foreign subsidiaries and in developing their networks of affiliates. The knowledge and institutional capacity developed during this process is both valuable and difficult to replicate; it will take many years for newer TNCs to develop a similar level of sophistication. As a result of their sophisticated networks, United States TNCs can enjoy the benefits of international diversification, such as a more stable stream of earnings over time, that result from their broad base of international sales and globally distributed assets (albeit with a home region bias). Thus, though recent events may have led United States TNCs to align their business strategies with the Government of the United States, this can be expected to be temporary; such firms will undoubtedly return to reliance on their sophisticated international networks as the primary source for competitive advantage.

In contrast, Chinese TNCs are newer, and tend to be focused upon natural resource seeking or (to a lesser extent) market seeking activities. As newcomers, they lack skills in systems integration and coordination, to such a degree that subsidiaries are generally bereft of managerial skills (Rugman and Doh, 2008). Without the benefits of international diversification, Chinese firms have little choice but to rely on their strong link with the Chinese government as the primary source for competitive advantage. Given this reliance and the close link with the government, Chinese TNCs can be expected to continue to help China recycle its huge financial surplus, inevitably increasing the economic power of China and Chinese TNCs relative to the United States and its TNCs.

5. Sustainable FDI

In terms of corporate governance, predictions about the impact of the financial crisis upon the role of TNCs as agents of sustainable economic development can only be speculative. Using stakeholder theory, it is apparent that leading Western TNCs long ago adopted the basic criteria of corporate social responsibility (CSR) and governance. Following this theory, as these TNCs go abroad as indirect national champions they spread the virtues of best-practice corporate social responsibility through their network. In fact, the networks of Western TNCs exhibit virtues of governance and sustainable development as predicted. In contrast, and unfortunately for proponents of CSR, TNCs from emerging economies are likely to be blunt instruments of home country policy primarily concerned with market entry and growth, with little interest in CSR. To the extent that the world financial crisis favours emerging economy TNCs at the expense of Western TNCs, there will be an overall negative impact on sustainable economic development and governance.

Though the rise of emerging economy TNCs may lead away from sustainable development in some regards, these TNCs *can* help to lead a sustainable recovery from the international financial crisis. The argument in favour of this proposition may best be explained using internalization theory, as follows.

Another way of thinking about sustainable FDI and the potential for recovery after the crisis is to revisit the basic point that FDI is not really a *macro* financial investment decision, but a *micro* real firm-level strategy decision. This distinction is expounded further in Buckley and Casson (1976), Rugman (1981), and the work of other internalization theorists. A firm's decision to build a wholly owned subsidiary is one of the entry mode options it can exercise, the others being exporting, licensing or joint ventures. Of course, the financing of any of these entry modes is always an important issue, but international business theory indicates that it is the micro entry mode decision which is the strategic driver, not the availability of financing.

Many analysts fail to understand this basic concept of international business, a fact which may stem from a misguided focus upon the data on FDI. These data are driven by mergers and acquisitions in which TNCs take over existing businesses. In contrast, FDI in greenfield manufacturing and new services leads to the creation of new business activity. However, while both mergers and acquisitions and greenfield investment rely upon a strategic decision taken by a firm, the FDI data on mergers and acquisitions are more volatile than those on greenfield FDI. In the recent financial crisis, FDI through mergers and acquisitions (especially for Western TNCs) appeared to collapse, whereas greenfield FDI (especially by Chinese TNCs) remained viable.

In short, the financial crisis led to a temporary fall in the large mergers and acquisitions component of FDI. This has constrained FDI by Western TNCs, but not as much by Chinese and other emerging economy TNCs which are driven by strategic decisions to engage in resource seeking and market seeking FDI. In general, the immediate collapse of Western FDI during and after the international financial crisis of 2008 is a temporary effect, and is balanced by the long term increase in FDI from China and other emerging economies. In this sense, looking beyond the superficial reveals that emerging economies are supporting sustainable FDI: the continued growth of greenfield FDI redistributes income toward emerging economies, while continuing to promote world economic development at large.

In other terms, TNCs from China and emerging economies are acting (like other TNCs) as agencies for economic development. International business theory suggests that when FDI is driven by firm-level strategy decisions, rather than by macro financial speculation, it is likely to be sustainable and linked to the growth of real resources in a sustainable manner. To this extent the "new" FDI from emerging economies serves to better balance world development, serving as an important engine for global sustainable recovery.

6. Conclusions

In this paper we have examined the impact of the international financial crisis on TNC strategy. We briefly examined the macroeconomic nature of the financial crisis and found that it has had an indirect impact on the strategies of TNCs. Our focus then turned to the increasing status of TNCs as national champions – the primary impacts of the world financial crisis on TNCs. While the trend may be most pronounced as United States firms centralize in response to United States Government policies, Chinese TNCs will continue to be much more strongly directed by the home country, as clear instruments of Chinese economic policy. In contrast, United States TNCs continue to be somewhat less centralized and hierarchical in their operations (with more autonomy to subsidiary managers in their networks). This suggests that United States TNCs are likely to benefit more from their sophisticated international network and international diversification than are Chinese TNCs. In short, the world financial crisis has complex repercussions on the strategies of TNCs, and these repercussions differ between regions, and in particular between Chinese and United States TNCs.

These differences may be expected to lead to increased rivalry between Chinese and United States TNCs. In acting as national champions, Chinese TNCs will find that regulations and the climate of governance will act as significant entry barriers, and as the rivalry between regions increases, the European and North American markets may become more difficult for the centralized and hierarchical Asian TNCs. This may reinforce the strong regional effect in which Chinese TNCs find themselves more successful in Asia and Africa, while North American and European TNCs focus even more on interregional activity, somewhat reducing the proportion of their activity in Asia.

The overall conclusion is that the decrease in FDI caused by the international financial crisis of 2008 is a temporary financial event largely offset by the ongoing real goods and services activities of TNCs. In particular, the TNCs from emerging economies, especially from China, will lead the recovery in FDI as they continue to expand, mainly on an interregional basis in Asia, though this expansion may be limited due to the fact that FDI from emerging economy TNCs is driven by country factors rather than by firm-level factors, and that these firms are also hierarchical and reflect home country values. In contrast, Western TNCs have better-developed overseas networks and are more responsive to issues of governance and corporate social responsibility. Further, the regulatory framework imposed in the United States and Europe during and after the international financial crisis of 2008 may serve to reinforce the intraregional nature of business activities by Western TNCs.

Overall, the continued rapid growth of FDI by Asian TNCs serves to balance the more constrained growth of FDI by the Western TNCs of the United States and Europe. This suggests that there will be a sustainable recovery in FDI as Asian TNCs take up a relatively greater role across the triad of TNCs from Asia, Europe and North America.

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Developing an international regime for transnational corporations: the importance of insolvency law to sustainable recovery and development

Jenny Clift *

This article examines the connection between insolvency law and sustainable recovery from financial difficulty or crisis and economic development. Set against the backdrop of the recent history of insolvency reform, it considers the convergence that has emerged on the goals and objectives for insolvency law and the need for, and desirability of, a universal insolvency regime that would facilitate the treatment of cross-border cases, particularly those affecting transnational corporations (TNCs). It highlights some of the difficulties associated with achieving such a regime, challenging the political and practical feasibility of that achievement. It concludes by reflecting on what has been achieved in the last 20 years and how that has paved the way for future developments.

1. Introduction

This article examines the importance of insolvency law to sustainable recovery and development and the desirability and feasibility of developing an international insolvency law for transnational corporations (TNCs). The examination is set against the background of insolvency law reform since the mid 1990s and the growing acknowledgement that good insolvency laws are closely linked to investment and development. It considers the direction that insolvency law reform has taken and the convergence that has occurred with respect to the underlying goals and objectives of that law and the increasing emphasis being placed on resolving cross-border insolvencies, particularly those affecting TNCs. While the underlying theme is the general desirability of achieving some kind of international insolvency regime applicable to these corporations, i.e. a single insolvency regime that can address the assets and business affairs of a TNC, wherever located, the article is grounded in the practical experience of international harmonization of insolvency law to date.

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This experience highlights the desirability as well as the political and practical challenges of achieving that goal.

2. Sustainability of insolvency regimes

The concept of sustainability as discussed in the context of development and the environment does not generally arise in the legal literature relating to the reform of insolvency regimes, and appears even less in literature discussing the desirability and feasibility of an international insolvency regime. To the extent, however, that that concept is concerned with issues such as the sustainable use of assets, the economic viability of business or the maintenance and maximization of value, it is inherent in much of the discussion that has taken place with respect to insolvency law reform over the years since the Asian financial crisis at the end of the 1990s.

Insolvency law is incontrovertibly linked to business failure and therefore, looking backwards, to debt and credit as key elements of the trading and other activities of a business. At its most basic, insolvency law might be characterized as a debt collection mechanism, preserving and marshalling assets for distribution to creditors. But generally insolvency law goes much further. It contains elements that can preserve viable businesses and their associated employment, provide efficient exit mechanisms for businesses that are not viable, and promote the effective redistribution and recycling of assets. All of these potentially sustain an underlying business that would otherwise be dismantled or recirculate assets that would otherwise be unproductive. By dealing effectively and predictably with those issues, it is suggested that insolvency law can promote the availability of finance and facilitate recovery from economic and financial crisis. An effective and efficient insolvency regime (which would include the law, its implementation and the institutions that support it) is one of the elements underpinning investment and economic development. There is, however, little empirical evidence to show how economically important insolvency law, and consequently insolvency law reform, might be. Moreover, there are examples, such as in China, where economic development and foreign investment have taken place despite the absence of well-developed insolvency law or in spite of antiquated or outdated laws (Tomasic, 2007; Halliday and Carruthers, 2009). Thus, the correlation between effective insolvency laws and investment must be regarded as an assumption. However, a connection between insolvency law and sustainability, if confined to the goals of preserving economically viable business, providing appropriate exit mechanisms, and redistributing and recycling assets, might be regarded as equally or more plausible. It is certainly a connection worthy of greater deliberation.

2.1 The impact of the financial crisis of the 1990s on insolvency law reform

The introduction to a study by the Group of Thirty (G-30, 2000, p.1) refers to the report of a body that was set up, following the failure of Barings[1] in 1995, to look at the supervisory, legal and financial problems that could arise in the context of a cross-border insolvency of a globally active financial institution, noting that:

> "while the Asian crisis and collapse of Barings had wide-ranging effects on financial institutions and investors, there was no .'knock-on' effect through the financial system that caused a globally active firm to fail. Fortunately, the international financial services community is enjoying a period of growth and appears to have its financial house in order. However, there is a growing concern by policymakers, the multilateral lending agencies and some global financial firms that when the next economic crisis hits, as inevitably it will, supervisory authorities and international investors and lenders may be no more prepared to deal with the legal risks of emerging market finance or the cross-border dimensions of insolvency than they were at the time of the Barings or Asian crisis. Financial institutions, multinational companies and international investors pursuing global investment strategies must understand better the practical implications of business failures in various jurisdictions and the insolvency risk of operating in those markets."

Much has changed in the world since that time, not least of all through the occurrence of the next crisis – this time global, with widespread financial, economic and social implications, including the failure of not one but a number of globally active firms. Much has also changed in

[1] The Barings Group comprised over 100 companies and had a diverse international securities and banking business. Joint administrators were appointed to the parent, Barings plc, and certain subsidiaries in February 1995.

the insolvency world. As the Asian Development Bank (ADB) (2000, p. 11) notes, the earlier regional economic crisis brought to the fore the need to address

> "the failings of the insolvency regimes of the Asian region, such as the lack of frameworks for the systematic restructuring of debt or the efficient liquidation of businesses incapable of being restructured, which pose impediments to economic recovery, complicate the rehabilitation of financial sector institutions, stifle foreign investment and inhibit the growth of the region's domestic debt markets."

The process of economic transformation taking place in a large part of the world, following the collapse of command economy practices and associated political ideologies, required a solution for the widespread failure of state-owned enterprises. This led to the development of insolvency regimes in states where formerly there had been none.

The Asian Development Bank stated that these events contributed to insolvency law assuming an "unparalleled national, regional and international importance" (ADB, 2000, p. 10), and Halliday and Carruthers (2009) note that they led to a dialogue between international financial institutions, global law-making bodies and international professional associations about the centrality of insolvency law and what constituted good law, as well as the role that they could play in assisting global law reform.[2] The event also led, ultimately, to a series of domestic insolvency law reforms (including, in some cases, several reforms in quick succession) across the world, much of the legislation responding to a recognition that effective and efficient modern insolvency regimes are important to all countries as a means of preserving viable businesses and thus employment, promoting the availability of finance and the effective redistribution and recycling of assets, facilitating recovery from economic and financial crises (United Nations General Assembly, 2004) and, with the limitations noted above, facilitating investment by providing an exit mechanism (Lamb, 2009). These developments also impressed upon governments the need to keep insolvency laws under regular review.

[2] Some of the key organizations involved in the dialogue at that time included the G-22, the Asian Development Bank, the European Bank for Reconstruction and Development, the OECD, the IMF, the World Bank and ultimately UNCITRAL.

At the same time as governments in a number of countries were reforming formal insolvency laws, the financial and banking sector was developing informal insolvency mechanisms,[3] which were adapted by some countries including Indonesia, Republic of Korea, and Thailand, as an adjunct to formal regimes, both to supplement and overcome the shortcomings of those regimes. As Halliday and Carruthers (2009) note, advantages of these informal workouts include the ability to move swiftly and in a manner that could be coordinated between creditors, while avoiding the costs associated with formal insolvency regimes. Cross-border insolvency also became the subject of some attention.

2.2 Developing norms for domestic insolvency law reform

In the early 1990s, the prevailing wisdom was that insolvency law was among the areas of law least amenable to international harmonization or cooperation (Tung, 2001). During a discussion of the growing significance of cross-border insolvency issues at a 1992 Congress of the United Nations Commission on International Trade Law (UNCITRAL), it was suggested by one commentator that:

> "it is not practical to think of harmonising the bankruptcy laws of ... different jurisdictions: in the evolution of international law we are simply too far away from any time when we could expect countries to have similar bankruptcy laws in an effort to stimulate international trade." (United Nations, 1995, p. 158).

The events of the 1990s, however, gave new impetus to the desirability of pursuing, if not substantive harmonization, movement towards the development and adoption of global standards and norms that could inform and shape insolvency law reform.

The systematic study of the state of 11 insolvency regimes across Asia initiated by the Asian Development Bank in 1997, had shown, as noted above, the lack of frameworks for restructuring debt and of efficient mechanisms for liquidation of companies. The ADB study (1999) argues for commonality in the commercial environment of most insolvency regimes and for recognition that basic principles

[3] One such example is the London Approach developed by the Bank of England and the INSOL Lenders Group (INSOL International, 2000).

of all insolvency regimes might be similar, although acknowledging that implementation might vary considerably. It articulates a set of 33 good practice standards covering core topics to be addressed by an insolvency law.

The European Bank for Reconstruction and Development (EBRD), tasked with fostering the transition towards market-oriented economies and promoting private and entrepreneurial activity in its 27 countries of operation, also started a considerable programme of work on law reform, including insolvency law, to improve investment climates. That work built upon the lessons learned from the Asian financial crisis, as well as from the transition countries of Central and Eastern Europe and the former Soviet Union, where insolvency provisions were not adapted to the newly established market economies. The EBRD work emphasizes that modern insolvency and debtor–creditor regimes are the "cornerstone of sustainable economic development" and provide a safety valve for financial failure, promoting the distribution and use of assets from failed businesses more efficiently, effectively and equitably. Moreover, that work shows, it was suggested, that "the better a nation's insolvency law is perceived (through comparisons to international standards and best practice), the higher the level of foreign direct investment and domestic credit that is available to the country" (Uttamchandani, 2010).

A report of the G-22's Working Group on International Financial Crises (1998) emphasizes that effective insolvency and debtor–creditor regimes are an important means of limiting financial crises and facilitating rapid and orderly workouts from excessive indebtedness. The report also identifies a set of principles and key features for effective debtor–creditor regimes.

The International Monetary Fund (IMF) Legal Department (IMF, 1999) discusses, in a booklet, the major policy choices to be addressed by countries when designing an insolvency law, distilled from IMF interventions among its members. Underlying those policy choices is a theory of law and economic development that good law, broadly understood, increases credit, which stimulates economic activity, which in turn produces economic growth (and, by implication, reduces poverty).

In 1999, the World Bank also commenced work on its Principles and Guidelines for Effective Insolvency and Creditor Rights Systems, which are intended to contribute to the development of a uniform framework to "assess the effectiveness of insolvency and creditor rights systems, offering guidance on the policy choices needed to strengthen them" (World Bank, 2001, p.1). At the end of 1999, UNCITRAL commenced work on the Legislative Guide on Insolvency Law, the goal of which is to provide a comprehensive statement of key objectives and core features for a strong insolvency, debtor–creditor regime (UNCITRAL, 2005).

As Halliday and Carruthers (2009) indicate, the outcomes of these different studies, principles and guides, represent a conjunction of interests among a varied set of actors that advanced the debate about the centrality of insolvency regimes to economic development and what a good insolvency law should include. Notwithstanding the different origins, motivations and preferences of the different actors, there is general agreement on the need to strengthen the international financial system, to accept that business failure is part of the normal business cycle and to recognize that strong insolvency and debtor–creditor regimes are an important means for preventing or limiting financial crises and for facilitating rapid and orderly workouts from excessive indebtedness (United Nations, 1999). Such regimes could facilitate the orderly reallocation of economic resources from businesses that were not viable to more efficient and profitable activities; provide incentives that would not only encourage entrepreneurs to undertake investment in businesses, but also encourage managers of failing businesses to take early steps to address that failure and preserve employment; reduce the costs of business and increase the availability of credit. Building upon the work of the ADB and the G-22, the distillation of a comprehensive statement of the key objectives and principles that should be reflected in a state's insolvency laws could be used to inform and assist insolvency law reform around the world.

Articulating the broader policy settings that should underpin a modern insolvency law, UNCITRAL (2005) suggests that these key objectives may include, for example, providing certainty to the market to promote economic stability and growth; maximizing the value of assets; ensuring equitable treatment of similarly situated creditors; facilitating timely, efficient and impartial resolution of insolvency; reducing the scope for disputes, and providing stakeholders with more information; ensuring transparency and predictability and preserving the insolvency estate to allow equitable distribution to creditors; and avoiding the rush to the court by creditors and the self-interested actions of business owners and managers in the face of insolvency. Although country approaches vary, there is broad agreement that an insolvency regime should seek to achieve these key objectives in a balanced manner. It should, for example, be compatible with and complementary to the legal and social values of the society in which it is based and which it must ultimately sustain. It must also seek to balance the inevitably conflicting range of interests that will coalesce around insolvency, including interests of the debtor, owners and managers of the debtor, creditors – including fiscal authorities, employees, guarantors of debt, suppliers of goods and services – and the legal, commercial and social institutions that are required for its implementation and ongoing operation.

There is growing international convergence not only around the goals of insolvency law,[4] but also around the types of mechanisms that should be available to achieve those goals. Many insolvency laws traditionally have focused on liquidation, with the result that the rules for liquidating businesses are largely universal in concept, acceptance and application (ADB, 2000; UNCITRAL, 2005). Secured creditors have generally been able to enforce their rights outside of insolvency without restraint, including by seizing their collateral, irrespective of the consequences for the continuation of the business, or to other creditors and employees. A change in thinking now places greater emphasis on balancing the advantage of near-term debt collection through liquidation with preserving the value of the debtor's business through reorganization, where reorganization may be interpreted to mean a type of proceeding whose ultimate purpose is to allow the

[4] In 2003, the International Working Group on European Insolvency Law, established by the Business and Law Research Centre at the University of Nijmegen in the Netherlands, completed its "Principles of European Insolvency Law" (2003). The Introduction notes that, notwithstanding the apparent and continuing diversity of national insolvency laws within the EU, many of those insolvency laws appeared to have common elements that, once identified, might provide the foundation for greater harmonization, thus responding to a concern that despite the ongoing economic integration in Europe and the trans-border nature of European business, insolvency laws continued to show substantial differences in underlying policy considerations, structure and content.

debtor to overcome its financial difficulties and resume or continue normal commercial operations, even though in some cases this may include a reduction in the scope of business, its sale as a going concern to another company, or its eventual liquidation. The emphasis on reorganization recognizes that not all debtors that falter or experience serious financial difficulty should necessarily be liquidated. A debtor with a reasonable prospect of survival should be given the opportunity to reorganize where it can be demonstrated that there is greater value (and therefore greater benefit for creditors in the longer term) in keeping the essential business operating. It is also recognized that there are businesses where the value of the technical knowledge and goodwill that may form the business's core cannot easily be realized through liquidation.

In addition to greater emphasis on providing a process for reorganization through the insolvency law, the role of informal workouts or voluntary restructuring negotiations is more widely recognized, noting the importance to the success of these mechanisms of an effective and efficient insolvency regime. These mechanisms are not a substitute for such an insolvency regime and rely for their impact on the leverage provided by the ability to resort to the insolvency law; it is often said that these mechanisms work best "in the shadow of the insolvency law" (UNCITRAL, 2005, chapter II, para. 3). It is estimated that in some states, significant numbers of insolvencies are resolved through the use of these procedures.[5] Generally, their use has been limited to cases of corporate financial difficulty or insolvency in which there is a significant amount of debt owed to banks and financial institutions, but such procedures do facilitate an earlier proactive response from creditors than might be possible under formal insolvency proceedings and have the added advantage of avoiding the stigma that often attaches to insolvency. The use of the rules developed to assist the conduct of these procedures is being widely promoted as an adjunct to reform of insolvency law to give greater flexibility to insolvency stakeholders and, in appropriate cases, avoid the delays and costs associated with formal proceedings under the insolvency law.

[5] In a presentation on out of court workouts, IFC/World Bank Group/World Bank Workshop on Insolvency Law Reform in Ukraine, December 2009, Sijmen de Ranitz suggested that in the Netherlands some 70–80 per cent of insolvencies are resolved in this way.

The greater the extent to which insolvency law reform reflects the key objectives and the substance of the recommendations contained in the guides and principles proposed by the various international organizations, the easier the development of an international insolvency regime may become, since there will be, potentially, less to disagree about in formulating the substantive elements of that regime.

3. Cross-border or international insolvency regimes

3.1 The need for an international insolvency regime

One area that is identified by the various international organizations in the works described above as requiring consideration is international (cross-border) insolvency. Efforts over a number of years to negotiate instruments such as treaties that could establish a single, potentially binding international regime have not borne fruit. The failure of early harmonization efforts within Europe, where it might have been expected that the underpinnings of economic integration would provide the necessary platform and leverage for agreement, underlines the degree of difficulty associated with achieving that goal. That failure also indicates, as Boshkoff (1994) argues, that harmonization of substantive insolvency law via a treaty may not be a viable solution.

From 1960, the intention was to develop an insolvency convention that would parallel the 1968 Convention on Jurisdiction and Enforcement of Judgements in Civil Commercial Matters. After some 25 years of negotiations, these efforts led to the 1990 European Convention on Certain International Aspects of Bankruptcy (the Istanbul Convention). Following only one ratification (by Cyprus), the Convention was superseded by a draft European Union convention on insolvency proceedings. Although European member States came close to adopting that draft convention in November 1995, implementation ultimately proved impossible for political reasons unrelated to the merits of the convention itself. It was revived in the form of a regulation in May 1999, which was adopted by the European Council on 29 May 2000 and came into effect on 31 May 2002. Further efforts continue; the Union Internationale des Avocats (UIA) recently raised, in the context of an UNCITRAL insolvency working group session, a proposal for a possible international convention in the field of international insolvency law, which might cover the following issues currently addressed by the UNCITRAL Model Law on Cross-Border Insolvency (the UNCITRAL Model Law): (a) granting of access to courts to foreign insolvency representatives; (b) recognition of foreign insolvency proceedings (with the effect of granting the foreign proceeding the rights of a national proceeding or triggering a secondary proceeding); and (c) cooperation and communication between insolvency representatives and courts. The proposal further suggests that if agreement on those issues seemed possible, the international convention might also contain provisions on: (a) direct competence ("convention double"); and (b) applicable law ("convention triple"), which could be part of a separate protocol (UNCITRAL, 2009).

Experience has shown that despite the potential of international treaties to provide a vehicle for widespread harmonization, the effort required to negotiate them is generally substantial, particularly in the field of insolvency where there is a close relationship between insolvency law and national judicial and civil procedure law, which varies greatly from state to state. Moreover, the more a treaty seeks to achieve in terms of hard commitments, the greater the difficulty in reaching agreement and the greater the attendant likelihood of failure.

Efforts to address the issue by promoting international models for domestic application, such as the UNCITRAL Model Law,[6] promulgated in 1997 and the only international legislative instrument addressing this issue, have had limited acceptance: aside from the 20 states that have enacted legislation based on the Model Law, few states have adopted provisions facilitating the treatment of cross-border insolvency. One reason for the failure of states to address cross-border insolvency domestically is possibly that they have been focused in the last decade or so upon improving and modernizing the domestic aspects of their insolvency laws. Another might be a perception that international insolvencies originate from, and largely affect, only a

[6] As at the end of 2010, states enacting legislation based upon the Model Law included: Australia (2008); British Virgin Islands, overseas territory of the United Kingdom of Great Britain and Northern Ireland (2005); Canada (2009); Colombia (2006); Eritrea (1998); Great Britain (2006); Greece (2010); Japan (2000); Mauritius (2009); Mexico (2000); Montenegro (2002); New Zealand (2006); Poland (2003); Republic of Korea (2006); Romania (2003); Serbia (2004); Slovenia (2008); South Africa (2000); and the United States of America (2005). Updated information is available at http://www.uncitral.org under UNCITRAL Texts and Status.

handful of countries, raising little concern or interest in others not so affected – a perception that should have been turned on its head with the recent spate of developed economies suffering from severe financial crisis. There may also be a view that pursuing cross-border insolvency is not cost effective for medium and small enterprises, and therefore is only relevant for very large enterprises, many of which traditionally have been headquartered in that handful of countries. In an increasingly integrated global economy, however, the reality is that cross-border business not only proliferates at all levels, it also fails. As more and more local companies become TNCs doing business across borders and owning assets in multiple countries, we have seen, and will continue to see, a corresponding increase in cross-border insolvencies.

Although the number of cross-border insolvencies has no doubt accelerated as a result of the current global crisis, the trend was well established before 2008. Because of the issues raised by those cases, there has been much discussion of the importance of devising an international insolvency regime, involving academics, policymakers, legislators, insolvency practitioners, judges and the like, and an examination of the possible shape of that regime. There has also been considerable activity of various types at different levels of the international insolvency community, including by the professionals involved in the day-to-day administration of cross-border insolvency cases and their professional associations, regional development banks, economic communities and the United Nations, to devise guidelines, standards and model laws to address aspects of that regime.[7] Nevertheless, it might perhaps be said of cross-border insolvency law reform that, as with the discussion arising from the Asian financial crisis of the necessity for rapid reform of the global financial architecture if the world were to avoid the occurrence of another major crisis, not enough has been done, or at least achieved (United Nations Expert Report, 2009). Incremental steps towards facilitating cross-border

[7] These include the Model International Insolvency Cooperation Act (MIICA) developed under the auspices of Committee J of the Section on Business Law of the International Bar Association and approved by the Councils of the International Bar Association and the Section on Business Law in 1989; the Cross-Border Insolvency Concordat developed by Committee J of the International Bar Association in the early 1990s and based on rules of private international law; and the Guidelines Applicable to Court-to-Court Communications in Cross-Border Cases developed by the American Law Institute (ALI) in 2000, as part of its work on transnational insolvency in the countries of the North American Free Trade Agreement (NAFTA).

insolvency have been taken, but the achievement of a widely accepted and widely available international regime remains elusive.

As Jay Westbrook (2000) indicates, the need for an international regime is not disputed. It is clear that increased cross-border trade and investment leads to a greater incidence of enterprises and individuals having assets in more than one state. It is also clear that when such an enterprise or individual becomes subject to an insolvency proceeding, there is often an urgent need to manage the supervision and administration of the insolvent debtor’s assets and affairs across borders. However, many states lack the legislative framework that would make that management possible, or facilitate it effectively through, for example, cross-border coordination and cooperation. The absence of predictability in the handling of cross-border insolvency cases can affect the manner in which a country is perceived as a destination for cross-border investment; a negative perception, as the Guide to Enactment of the UNCITRAL Model Law (1999) suggests, may impede capital flow and act as a disincentive to cross-border investment.

Where the goal of insolvency proceedings concerning a TNC is liquidation, an acceptable result may be achieved when conducted in different states on a national basis. Any other solution, such as reorganization of the business on a basis that reflects its organizational and operational structure before the onset of insolvency and enables a fresh start, requires an international regime or, at the very least, a significant degree of cooperation and coordination with respect to the management of insolvency proceedings between the different states involved. The absence of such an international regime and inadequate coordination and cooperation in those cases reduces the possibility of rescuing financially troubled but viable businesses, impedes a fair and efficient administration of cross-border insolvencies (making it more likely that the debtor’s assets will be concealed or dissipated), and hinders the reorganization or liquidation of debtors’ assets and affairs in a way that would be the most advantageous for the creditors and other interested persons, including the debtors and the debtors’ employees.

There are two key dimensions to the difficulties encountered when a debtor operating in a cross-border context becomes insolvent. The first is that, notwithstanding the increasing globalization of the manner in which businesses operate, corporate regulation and insolvency remain largely issues for individual states, whose laws are characterized by broad diversity. While the compartmentalization of business regulation might have less impact or be less important when the business is healthy and functioning (the organization of business activities and the structure of TNCs in different states is necessarily a response to that diversity of regulation), the onset of insolvency turns a cohesive international business into a set of potentially disconnected segments in different countries, subject to different insolvency laws, each embodying the particular state's choice of social, economic and financial policies, with different priorities and different sets of creditors claiming different assets under different rules (Farley, 2006).

The second dimension is an extension of the first, and relates to enterprise groups.[8] Despite their ubiquity in both emerging and developed markets and the scale of their involvement in international business activity – the largest economic entities in the world are not only states but include enterprise groups, the largest of which may be responsible for significant percentages of gross national product worldwide, with annual growth rates and turnovers that exceed those of many states (Khanna and Yafeh, 2007) – much of the legislation relating to corporations deals with the single corporate entity, rather than with any notion of an enterprise group as a legal personality. In fact, as the UNCITRAL Legislative Guide on Insolvency Law indicates, very little legislation refers specifically to enterprise groups or recognizes the "enterprise group" as a legal concept, except in limited ways for very specific purposes, such as fiscal and accounting purposes. For insolvency purposes, no state has a comprehensive regime for the treatment of groups in insolvency, with the result that each group is nothing more than a collection of individual entities − in some cases a very large number of such entities[9] − each of which has to be administered separately.

[8] There are many possible definitions of enterprise groups, but most concentrate on the connection between two or more enterprises on the basis of control or significant ownership.

[9] "A study based upon the 1979 accounts and reports of a number of large British-based multinationals, for example, had to be abandoned with respect to two of the largest groups, with 1,200 and 800 subsidiaries respectively, because of the impossibility of completing the task. Researchers noted that few people inside the group could have had a clear understanding of the precise legal relationships between all group members and that none of the groups studied appeared to have its own complete chart. Similarly, the group charts of several Hong Kong property groups such

The insolvency in 2008 of Lehman Brothers, although perhaps an extreme example, setting as it does the record for the largest insolvency case ever filed in the United States, illustrates the problem. In May 2009, nearly 80 different insolvency proceedings commenced in more than 16 different jurisdictions, each of which has to be treated separately and each of which will differ in its form and scope, in accordance with the applicable law. While some of the states involved have adopted the UNCITRAL Model Law and therefore have at their disposal some mechanisms that might be used to facilitate coordinated administration of these different proceedings, many do not. As noted in the motion seeking approval by the United States Bankruptcy Court of a cooperation agreement in the Lehman Brothers case (2009, para. 10),

> "Given the integrated and global nature of Lehman's businesses, many of the debtors' and foreign debtors' assets and activities are spread across different jurisdictions, and require administration in and are subject to the laws of more than one forum. The efficient administration of each of the individual proceedings would benefit from cooperation among the official representatives on a multitude of common issues and matters. In addition, cooperation and communication among tribunals, where possible, would enable effective case management and consistency of judgments."

Despite ongoing globalization and economic integration, insolvency law has remained stubbornly resistant to treaties and other international efforts to design some form of unified, global regime for resolving private financial defaults (Pottow, 2005; Block-Lieb and Halliday, 2007). As a United Nations Expert Report (2009) notes, "Our systems for resolving cross-border defaults … are not what they should be to deal with twenty-first century globalization".

as Carrian, which failed over 20 years ago, ran to several pages and a reader would have needed a good magnifying glass to identify the subsidiaries. The group chart of the Federal Mogul group, an automotive component supplier, when blown up to the point where you can read the names of all the subsidiaries, fills a wall of a small office. The group chart of Collins and Aikman, another automotive group, is printed in a book, with sub-sub-groups having the complexity of structure of many domestic enterprise groups" (UNCITRAL Legislative Guide, part three, chapter I, para. 14).

3.2 Devising an international insolvency regime

Universalism vs. territoriality

Much of the discourse over the appropriate design for an international insolvency regime has focused on the two competing theories of "territoriality" and "universalism". It is not necessary to go further than outline the key points of that debate here, which is addressed in more detail in, e.g., Westbrook (2000), LoPucki (2000), Tung (2001), and Bebchuk and Guzman (1999). In brief, those countries that adhere to the principle of "territoriality" do not recognize foreign proceedings and assert the sovereignty of domestic law (at least with regard to "domestic" assets) to the exclusion of any form of coordination or cooperation with foreign insolvency proceedings. In contrast, under the principle of "universalism", the insolvency law of the debtor's home country would govern the debtor's insolvency worldwide, allowing the home country court global access to assets, creditors and their claims in a single insolvency administration.

Conceptually, universalism is very attractive. As Tung (2001, p. 71) concludes: "it is neat and clean, simple and sweet. In the face of inexorable globalization, the notion of a cooperative, internationalist, one-court, one-law bankruptcy system seems irresistible." A unified proceeding would enable one court in one country to administer all of the debtor's assets and affairs, wherever located or undertaken. Value could be maximized; use and disposition of assets would be coordinated; creditors would be treated equally, without the vexing distinction between local and foreign creditors; conflict between competing proceedings would be avoided; the absence of duplication would lead to lower administration costs, and so forth. Guzman (2000) argues further that such an approach would be more predictable, and the combination of predictability, greater transparency and lower costs would, in turn, lower the cost of credit. For these reasons, universalism probably enjoys a level of support that is inversely proportionate to its current acceptance by policymakers around the world (Pottow, 1999, p. 1904).

In comparison, Pottow (1999) notes that under territoriality, which has traditionally been the dominant practice, each country in which the debtor has assets administers those assets under its own laws, without reference to the laws of any other country in which the debtor might operate or have other assets. As a concept, it pays scant attention to the cross-border or international nature of business. It inherently leads to segmentation and, it is argued, inefficiency through the costs associated with the opening of duplicative multiple proceedings, the requirements to monitor the international movement of assets and master different insolvency laws, as well as manage potential conflict between competing proceedings and so forth.

Although the traditional approach to insolvency law is territoriality, there has been some movement towards embracing more universalist principles as a result of recent domestic reforms. However, the existence of various forms of territoriality and universalism in the insolvency laws of different states has meant that when, for example, a debtor that owns assets in a number of states becomes insolvent in one of those states, the other states involved may take inconsistent or conflicting approaches to the conduct of those proceedings. The state where the insolvency is declared, for instance, may claim jurisdiction over all assets wherever located and seek to administer them within a single proceeding. Other states where assets are located, but whose laws are not based upon that same principle, may claim jurisdiction over assets simply on the basis of their location and seek to administer them in a local proceeding. This approach can lead to a multiplicity of proceedings concerning the insolvency of the same enterprise. As Booth (1992) recognizes, the attendant disadvantages of such multiple proceedings can lead to inequity and instability in the climate for international trade.

Economic analysis of the two concepts suggests that the impact of each is not necessarily well understood in the legal discussion. Analysis conducted by Bebchuck and Guzman (1999) shows that the choice of legal regime not only affects the distribution of assets in insolvency, a consequence that is well understood in the debate, but also that it has an *ex ante* effect on the allocation of capital. Territorialism distorts the decision to allocate capital and has an efficiency cost greater than previously realized. Moreover, although the adoption of a territoriality approach is generally believed to benefit local creditors, it may actually fail to do so, in the event that domestic and foreign lenders adjust the terms of their loans on the basis of the legal regime in place. Foreign lenders, for example, are likely to charge higher interest rates, while local lenders who may have an advantage in insolvency, have an incentive to charge less, but will not necessarily be able to lend more on the basis of those lower interest rates. Territorialism, however, is likely to benefit the country adopting that approach if the investment brings with it employment, technology, taxes and other similar benefits.

Although universalism may seem attractive and forward-thinking, Tung (2001), focusing on the global resolution of global problems, concludes that it is implausible, both practically and politically. A universalist regime has not so far come into being and, I would venture, is unlikely to emerge any time soon.

A key obstacle to the emergence of such a regime is that states are generally reluctant to commit to universalism, requiring as it does significant deferral to the sovereignty of foreign states and the potential control or domination of local events by those foreign states, their laws and institutions and the accompanying loss of ability to regulate one's own affairs. This reluctance is evidenced not only in insolvency but elsewhere by, for example, the limited extent to which states are prepared to recognize foreign civil judgments (Baumgartner, 2003). There is also an inherent suspicion of the impact of a foreign insolvency administration on domestic creditors and employees and of the ability of the foreign court to appreciate or take into consideration any of the social and economic policy concerns important to the other state (and probably underpinning that other state's insolvency law). Local creditors – perhaps naturally – expect local law to apply to the insolvency of the locally operating firm with which they have dealt, without considering that it might be an international firm or part of an enterprise group, or what might happen in the event of its insolvency.

These issues can be particularly significant when the interests of developed and developing countries are on opposite sides of the insolvency proceedings. One possible example of this may be a manufacturing plant in a developing country with 5,000 employees owned by a foreign debtor, whose principal insolvency proceedings are managed from a distant capital in a developed country. An added dimension is the expectations of the host state that its law will apply not only to the establishment and operation of an entity on a day-to-day basis, but also to its insolvency, should it occur. The natural consequence of these considerations is a desire to protect local interests and creditors by resorting to territorialism, “ring fencing” local assets, applying local law and questioning the benefit to local creditors and local interests of cooperating with foreign courts.

A further obstacle to universalism is a tendency to prejudge the outcome of the application of foreign insolvency law and assume that local creditors will always lose out to foreign creditors. The manner in which that issue is resolved, however, will depend upon the type of proceedings in question (i.e. liquidation or reorganization) and the circumstances of the particular case. While the amount to be distributed to a creditor may be relatively straightforward to determine in the case of liquidation, in reorganization much may depend on the interests of the particular creditor, rather than upon the relative amounts that it may receive through quarantining local assets or pooling them with all other assets of the debtor, wherever located (Waldron, 2002, p. 10). Employees, for example, may have a greater interest in ongoing employment than in a distribution, while trade creditors may derive more benefit from a continuing marketplace for their goods and services. Very often, a loss in one case may be balanced with a gain in another.

There may also be reluctance on the part of some courts and insolvency representatives to view an insolvency case as involving an international element, especially where the matter appears to lack a foreign debtor, foreign creditors or foreign operations. If each member of an enterprise group is a locally incorporated entity that can be dealt with separately under local rules, there may be no perceived need for (or indeed benefit in) taking wider connections to an enterprise group into consideration or, where the foreign debtor has local assets, in considering how those assets might fit into a global insolvency estate. While this approach might be appropriate in some cases, for a globally integrated business it might generally mean the local operation has limited possibilities for reorganization and is likely to be liquidated, with an attendant loss of jobs and investment. A debtor may also be treated as a purely local debtor because there is no mechanism under domestic law that would enable it to be treated in any other way.

The middle ground – modified universalism

A pragmatic middle ground that avoids the polarities of universalism and territoriality is described by Westbrook (2000, p. 2293) as "modified universalism", a form of universalism that is "tempered by a sense of what is practical at the current stage of international legal development". This is the approach adopted by the UNCITRAL Model Law, a text that provides an interface between different insolvency regimes, but does not attempt to harmonize substantive insolvency law. As a model law it is flexible, enabling a certain degree of adaptation by enacting states to suit domestic conditions (although it should also be said that the more a state changes the terms of the model, the less clear it is that the model has been adopted).

Within those constraints, the UNCITRAL Model Law promotes a high degree of predictable recognition, assistance and cooperation for cross-border insolvency, at the same time acknowledging that there might be situations where public policy grounds require non-recognition of the foreign proceedings and that local proceedings do have an ancillary role to play in addressing local assets.

At a regional level, the European Union (EU) Insolvency Regulation adopts a similar approach. Given the environment within which it operates (i.e. amongst a limited group of member states), it is able to go a step further towards unifying the process of administration of insolvency proceedings.[10] However, as Paul Omar (2009, p. 383) notes, issues of sovereignty are still a factor, reflected in the fact that the Regulation permits secondary proceedings. Where TNCs and groups conduct the majority of their business on a regional basis, the approach of the EU Insolvency Regulation may provide an alternative answer to the quest for an international insolvency regime, at least for the members of that region. Where business is conducted between regions, however, the regionalization of insolvency regimes would provide only a partial solution and some way of interfacing between the different regions would still be required.

[10] The EU Insolvency Regulation provides that insolvency proceedings commenced in one member state must be recognized in other member states, a situation not applicable outside the EU.

Determining the debtor's home country or COMI

In addition to the concerns discussed above, universalism requires a viable, widely accepted choice-of-law rule to determine the jurisdiction that will control the insolvency proceedings worldwide. Universalism refers to the debtor's "home country", but there is some uncertainty surrounding the definition and thus the location of that "home country". This is a concern raised not simply in the context of the debate on universalism versus territoriality; a similar concept, that of "centre of main interests" (COMI), is used in both the UNCITRAL Model Law and the EU Insolvency Regulation. It is not defined in either instrument, and is one of the issues most productive of controversy in the application of the Model Law and the EU Regulation. [11] Much has been said and written about COMI over the last few years in works such as Moss (2006), Sarra (2008), and Westbroook (2006–2007), and does not need to be repeated here. In short, what constitutes, or should constitute, the COMI of a debtor is not free from doubt. While various commentators discussing the home country issue in the context of universalism some years ago were of the view that it was not likely to prove as difficult to determine as others had suggested (Tung, 2001), there have been decisions concerning, for example, the COMI of financial entities registered in certain countries of the world but largely doing business elsewhere, as well as decisions on EU entities, that have proven to be controversial.[12]

In the case of the EU Insolvency Regulation, the discussion of COMI has raised questions of forum shopping, given an increasing occurrence of debtors moving their seat within member States of the EU in close proximity to the onset of insolvency. For example, as Anoushka Sakoui (2009) notes, "a number of international companies are considering moving to England to benefit from friendlier insolvency laws and give themselves a better chance of survival, according to City

[11] Recital 13 provides an explanation of the term, article 3 provides the applicable presumption of registered office or habitual residence.

[12] See, e.g. the *Bear Stearns* decision: *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.* 374 B.R. 122 (Bankr. S.D.N.Y. 2007) and *In re Bear Stearns High-Grade Structured Credit Strategies Master Fund, Ltd.* 2008 WL 2198272 (S.D.N.Y. May 27, 2008); and the decision of the courts in the UK and Canada on *Stanford International Bank*: UK - [2009] EWHC 1441 (Ch); Canada - Case 3:09-cv-00721 –N, Quebec, Montreal, 11 September 2009; see also the series of articles on the *Bear Stearns* decisions in INSOL World, Second and Third Quarters 2008.

of London-based lawyers". Questions have also been raised about the willingness of some courts to take a liberal view of what constitutes COMI in order to accept jurisdiction. One example often cited is that of Eurofoods, a Parmalat subsidiary, where courts in both Italy and Ireland claimed to be the COMI of the subsidiary. It is perhaps to be expected that in such situations, each country is likely to think that its regime makes the most sense and comports most closely to its conception of fairness, leading it to emphasize the rightness of its claim to jurisdiction and minimize situations in which it will have to defer to another (Pottow, 1999). Some of these questions of forum shopping and jurisdiction relate to the difficulty of applying the concept of COMI to an enterprise group in order to bring all group members within the jurisdiction of one court. It is important to note that the single international legal text specifically applicable to the problem posed in the group context, that of coordinating the insolvency of a group of different debtors, albeit members of the same enterprise group, addresses the issue by way of recommendation to legislators.[13] Existing laws, including those based on the UNCITRAL Model Law, focus on coordinating the insolvency of a single debtor or TNC with assets and operations in different countries.

Limiting application of an international regime to large multinationals

One means of dealing with the local concerns raised by universalism has been to suggest that an international regime could be addressed only to large TNCs; local policies would be applied to local enterprises (Westbrook, 2000). However, as Tung (2001, fn. 82) notes:

> "if the size of the firm bears any relation to the level of its local activity, it would seem that a 'large' firm would be at least as likely to engage in significant numbers of local transactions – employment and supply contracts, for example − as a smaller multinational firm. The failure of a large multinational may have significantly greater local effects than failure of a small one."

[13] The UNCITRAL work addressing the treatment of enterprise groups in insolvency, both domestically and internationally, was adopted by the Commission on 1 July 2010 and forms part three of the UNCITRAL Legislative Guide on Insolvency Law. The concept of COMI is the subject of further work by UNCITRAL, including with respect to enterprise groups: see United Nations document A/CN.9/WG.V/WP.95 and Add.1, available online at http://www.uncitral.org/uncitral/en/commission/working_groups/5Insolvency.html (last visited 3 December 2010).

Added to that would be the difficulty of reaching a universally agreed definition of what constituted the requisite size for the international regime to apply.

The importance of cross-border cooperation

In the absence of relevant national and international laws addressing cross-border insolvency, cooperation has become an essential element of practice in cross-border insolvency cases. To date, cooperation between courts and insolvency professionals with respect to the administration of insolvency proceedings conducted in different countries has proven to be the most effective way of managing those proceedings and minimizing conflict, delay and cost. For many groups, cooperation may be the only way to reduce the risk of piecemeal insolvency proceedings that have the potential to destroy going concern value and lead to asset ring-fencing, as well as asset shifting or forum shopping by debtors.

However, cooperation is not without its problems. Firstly, many states lack the legislative framework and authority to enable their courts and insolvency representatives to cooperate; in some cases, this might even raise constitutional issues concerning recognition of foreign judgments and the independence of judges. Secondly, where the legislative authority does exist, there are diverse understandings between the various stakeholders as to whether, for example, cooperation is a given in all cases or should be considered on a case-by-case basis; on the forms of cooperation that might be both available and acceptable to courts, insolvency representatives and parties alike; the practicalities of cooperation (e.g., whether it should involve direct communication, exchange of documents or sharing of information); and the impact of that cooperation on the authority and independence of domestic courts. Thirdly, experience with cross-border cooperation is common between only a handful of states and there is a significant need for judicial education that facilitates sharing of experience, understanding of the issues, exchange of information, and so forth.[14]

[14] For a discussion of some of the issues associated with judicial cooperation, see the report of the UNCITRAL/INSOL/World Bank Eighth Multinational Judicial Colloquium on Insolvency, 20–21 June 2009, Vancouver, Canada, available online at http://www.uncitral.org/uncitral/en/commission/colloquia.html (accessed 3 December 2010).

Various means have been developed to facilitate cooperation in cross-border cases; while the UNCITRAL Model Law provides the requisite legislative framework, it merely lists various possible forms of cooperation without providing further guidance as to how cooperation might be implemented. Faced with the daily necessity of dealing with insolvency cases and attempting to coordinate their administration in the absence of widespread adoption of facilitating national or international laws, the insolvency community has developed cross-border insolvency agreements. These are designed to address the potential procedural and substantive conflicts arising in those cross-border cases, facilitating their resolution through cooperation between the courts, the debtor and other stakeholders across jurisdictional lines to work efficiently and increase realizations for stakeholders in potentially competing jurisdictions. While these agreements are no substitute for an appropriate legal framework, they have simplified and streamlined the cross-border administration of proceedings and reduced conflict in a number of cases. For example, in the bankruptcy proceedings of Everfresh Beverages, Inc.,[15] it was estimated that the enhancement of value achieved through use of such an agreement between US and Canadian entities was in the order of 40 per cent. The increasing prevalence of these agreements has led UNCITRAL to prepare a compilation of practice with respect to their use.[16]

4. Conclusion

Significant progress has been made in the last decade or so with respect to the reform of domestic insolvency law and the development of norms and standards that might be said to represent international best practice. The underlying premise of that work is that effective legal frameworks permit predictability and certainty and that predictability and certainty stimulate investment, economic growth and global trade. Global legal instruments therefore facilitate global economic development and expansion.

Less progress has been made with respect to cross-border or international insolvency. The debate about an international insolvency

[15] Everfresh Beverages Inc., Ontario Court of Justice, Toronto, (Canada) Case No. 32-077978 (20 December 1995) and the United States Bankruptcy Court for the Southern District of New York, Case No. 95 B 45405 (20 December 1995)

[16] UNCITRAL Practice Guide on Cross-Border Insolvency Cooperation (2009)

regime raises fundamental tension between local issues (the protection of local creditors and small-country sovereigns) and the pursuit of the global benefits that underpins the argument in favour of that international regime. The instruments that have been developed focus on providing an interface between national laws, and are slowly gaining acceptance. Nevertheless, since many cross-border insolvencies are viewed, at the present time, as largely emanating from a handful of developed economies where TNCs tend to be headquartered, it can be difficult to explain or demonstrate the global benefit claimed for cross-border proceedings. It is likely to be some time before increasing globalization, including the spread of foreign investment, sufficiently diversifies the source of cross-border insolvencies to create a broad(er) community of interest in their resolution.

Those instruments do not, however, amount to what might be described as "an international insolvency regime", at least in so far as that regime requires a single law and single court to administer the insolvency proceedings for a TNC or enterprise group. Nevertheless, they are a significant advance on what existed before their development and their success has proven to be the catalyst for further steps to be taken. It is suggested by Block-Lieb and Halliday (2007) that success lies in incremental reform in insolvency, reform that Potow (2005, p. 1011) argues would allow "sovereignty-sensitive states to acclimate to the extraterritorial reach of foreign laws". Small steps taken today may well pave the way for large strides in the not-too-distant future, particularly with the impetus of the current international climate. Or they may, at the very least, pave the way for continuing the small steps towards improving the regime for addressing the insolvency of TNCs and enterprise groups.

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Bhagwati, Jagdish (1988). *Protectionism* (Cambridge, MA: MIT Press).

Cantwell, John (1991). "A survey of theories of international production", in Christos N. Pitelis and Roger Sugden, eds., *The Nature of the Transnational Firm* (London: Routledge), pp. 16–63.

Dunning, John H. (1979). "Explaining changing patterns of international production: in defence of the eclectic theory", *Oxford Bulletin of Economics and Statistics*, 41 (November), pp. 269–295.

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