INVESTMENT *FOR* DEVELOPMENT: CHALLENGES AHEAD

EPILOGUE

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

- to strike the right policy balance (liberalization versus regulation; rights and obligations of the State and investors);
- to enhance the critical interfaces between investment and development, such as those between foreign investment and poverty, and national development objectives;
- to ensure coherence between national and international investment policies, and between investment policies and other public policies.

All this calls for a new investment-development paradigm and a sound international investment regime that effectively promotes sustainable development for all.

Backdrop

Since the first *World Investment Report* in 1991, TNC's have evolved immeasurably, partly in response to the opportunities and challenges presented by the process of globalization. New players, markets and organizational forms have emerged. At the same time, the process has included a vast expansion of the private sector into previously regulated areas of the economy. It is also associated with a series of recurrent financial and economic crises. These crises have triggered, among others, serious and profound questions regarding the implicit social contract on which the balance between public and private governance is built, both nationally and internationally. It is now increasingly argued that, in the face of globally critical policy and development challenges such as recurrent financial crises, climate change and food security, and the true urgency of actions required at the institutional, technological and economic levels, a new approach to harnessing markets for development is required. This new approach has important ramifications for the investment-development nexus.

The evolving nature of the TNC universe

The opportunities and challenges offered by the global economy – encouraged and fostered by government policies, economic growth, competition, technological change and social developments – have resulted in changes to TNC strategies and structures. At the same time TNCs are an integral part of the process of globalization, impacting on and determining trends and developments. In particular, they have played a role in shaping the nature and characteristics of existing and emerging international markets and industries. There have been notable changes in the strategy and composition of FDI, for example in the increasing share of services in FDI flows, and the rise of extractive industries, infrastructure and agriculture as major areas of TNC activity, especially in developing countries (*WIR00*, *WIR04*, *WIR07*, *WIR08*, *WIR09*). As TNCs have widened and deepened their international expansion into new markets, especially in emerging economies, key issues of particular salience for the current and future role of TNCs in development include:

The rise of integrated international networks. Dynamic competition between TNCs has resulted in a fine-grained splitting of value chain activities and their dispersion. Initially primarily focused on production and operations (including by services companies), this dispersal of activities across borders, but coordinated under the auspices of one firm, was first referred to as "integrated international production" (*WIR93*). Increasingly, however, similar coordination is being achieved between independent or, rather, loosely dependent entities, which can perhaps be referred to as "integrated international networks". This has implications for a wider use of non-equity modes of TNC operation in host countries, as discussed below. Moreover the dispersal of the value chain internationally is increasingly across the whole gamut of TNC functions (but to different degrees), including R&D and design (*WIR05*). In the latter case, TNCs are both benefiting from and helping to build indigenous clusters of innovative activities in emerging markets.

Widening use of non-equity modalities. Over the past two decades or so, the expansion of various non-equity modes of TNC activity in host countries has become a significant feature of the emerging global division of labour. These non-equity modes include various types of international supplier and distribution relationships, e.g. international subcontracting in manufacturing industries such as automobiles, electronics and garments (Giroud and Mirza, 2006); contract farming in agriculture and food processing

(*WIR09*); international franchising in fast food retail stores; variations of build-own-operate-transfer arrangements and other concessions in infrastructure projects (*WIR08*); and management contracts in international hotel chains (UNCTAD, 2007c). The increased use of non-equity modes by TNCs may foster greater levels of interaction and diffusion of knowledge to domestic firms. This has been particularly salient in recent years in sectors such as infrastructure and agriculture, where non-equity forms of TNC activity have contributed to economic upgrading and institution-building in host countries (*WIR07, WIR08, WIR09*).

A broader range and types of TNC players. With TNCs' exponential expansion worldwide has come the rise (or re-emergence) of different types and forms, some with quite distinctive business models. This wider range of forms can be categorized in different ways: by internal and external coordination of TNC activity (as discussed above); by origin, as evidenced by the rise of TNCs from developing and transition economies (*WIR06*); by ownership, for example the expansion of FDI by state-owned TNCs, sovereign wealth funds (also state-owned) and private-equity funds; and by structure, such as "umbrella groups" from emerging countries (i.e. small family-owned firms managed collectively). These categories are not mutually exclusive, nor complete; however, in addition to representing competition for existing TNCs, these players also open up opportunities and risks for host countries.

The ascent of TNCs from the South, for instance, raises two particular issues. First, a re-emphasis of the fact that created asset-seeking strategies (e.g. acquisition of know-how, brands and distribution networks) by TNCs are becoming more prevalent. Secondly, the rise of South-South FDI is increasing opportunities for developing host countries (as these new players bring unique assets, skills and business models to the fray), as well as boosting and deepening competition with developed country TNCs in areas where the latter previously possessed greater market power (*WIR06*).

The development dimension in the TNC "universe". The TNC universe delineated above has critical implications for development. From the perspective of development stakeholders, a wide-ranging discussion of economic power arises from, among others, TNC control of technology and markets in global value chains. For instance, how is this power yielded to control domestic suppliers of agricultural produce in developing countries (*WIR09*) and how might this impact on food security? In this respect, many TNCs have been targeted by civil society and suffered loss of reputation due to exposure of, among others, their labour, environmental or human rights practices.

Partly because of this, but also because integrated international networks have a multiplicity of stakeholders with different interests, corporate self-regulation is increasingly important. This has led to various types of initiatives under the banner of good corporate citizenship or corporate social responsibility (CSR), such as compliance with voluntary environmental or labour standards, and bilateral and multi-stakeholder initiatives. Partnerships with NGOs can form an integral part of the value-creating process of TNCs, as can various types of agreements that fit under the overall rubric of public-private partnerships (PPPs). In large-scale infrastructure projects, for instance, PPPs may best be realized by combining and balancing the various resources, assets and objectives which public and private/TNC partners can bring to bear. While some headway has been made, TNCs need to do more to factor in the development dimension and the public interest into their business decision-making, and to find the right balance between the "bottom line" of business shareholders and the "bottom line" of development stakeholders. This has become a major challenge for firms today.

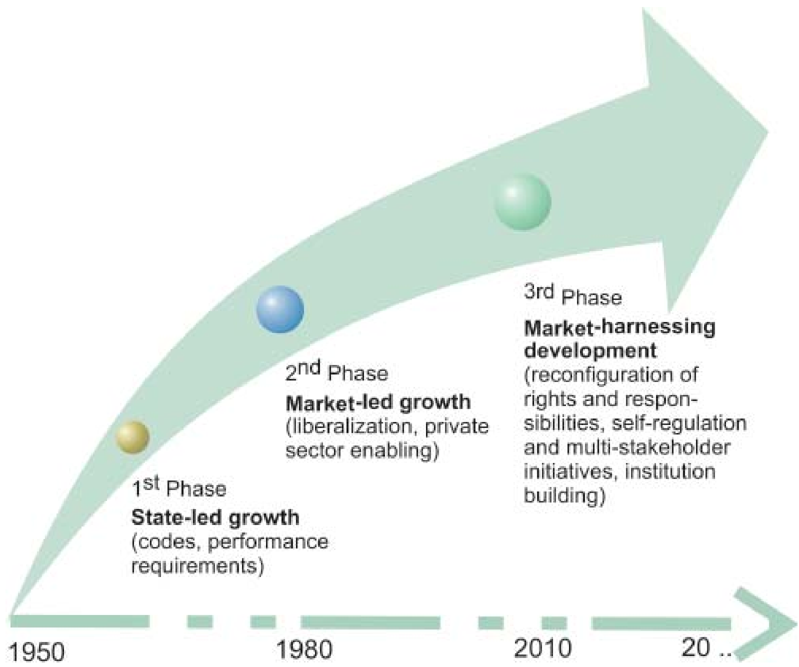
Evolving trends in investment policies

The TNC universe described earlier, i.e. the wider diversity and range of different kinds of firms and control arrangements under the TNC umbrella, has major policy implications for both home and host countries and at both national and international levels. For example, the rise of Southern TNCs has changed not only the investment policy perspective of governments of the South, but also that of the North. Partly for this reason, the pendulum has recently begun swinging towards a more balanced approach to the rights and obligations between investors and the State, with distinctive changes in the nature of investment policymaking. The defining parameters of these changes in investment policy making include the following:

Dichotomy in policy directions. There are simultaneous moves to further liberalize investment regimes and promote foreign investment in response to intensified competition for FDI, on the one hand, and to regulate FDI in pursuit of public policy objectives, on the other. This "dichotomy" in policy directions is in contrast to the clearer trends of the 1950s–1970s (that focused on State-led growth) and the 1980s–early 2000s (that focused on market-led growth). Today's dichotomy results from a rebalancing of public and private interests in pursuit of market-harnessing development, with governments putting in place policies and mechanisms which enable and incentivize, as well as regulate market actors to better meet development objectives (fig. V.1). It was triggered by the various crises; however it also reflects the recognition that liberalization, if it is to generate sustainable development outcomes, has to be accompanied – if not preceded – by the establishment of proper regulatory and institutional frameworks.

Devising effective mechanisms for implementing adequate policy, regulatory and institutional frameworks, in a manner taking account of countries' different stages of economic, social and institutional development, is a challenging task. Multiple global crises (e.g. financial, food, energy, climate change) have reinforced calls for better regulation of the economy – including foreign investment – that has further spurred a series of international and domestic reform processes. Most prominent are regulatory changes in the financial sector, but there are also some in other areas of economic activity. Examples include recent efforts by UNCTAD, FAO, the World Bank and IFAD to establish principles for responsible investment in agriculture (*WIR09*), as well as global efforts for a future regime for combating climate change (chapter IV).

Figure V.1. The evolution of policy approaches towards foreign investment



Source: UNCTAD.

Striking the right balance between rules and laissez-faire poses a formidable policy challenge. This is closely linked to rebalancing the rights and obligations of the State and the investor; and adjustments at the national investment policy level are occurring to different degrees across sectors and types of regulations. This is a challenging task for several reasons. First, more regulation is a double-edged instrument: while regulation can enhance development gains, overregulation can be counterproductive. Secondly, many policy tools are available, but finding an adequate and effective policy mix between promotional and regulatory elements is difficult. Third, the new balanced approach needs to be rigorous, adapting to an economic and political environment that is constantly changing. Fourth, such a rebalancing process should not be hijacked by investment protectionism. In an increasingly interdependent world, "beggar-thy-neighbour" policies are ultimately harmful to all countries, and undermine the longer-term development of countries that pursue such policies.

Above all, investment regulation is a must, and the key is not the quantity but the quality of regulation, i.e. its effectiveness and efficiency.

The balancing of public and private interests is also central to self-regulating corporate social responsibility initiatives. While participation in these types of initiatives is voluntary, such engagement increasingly comes with obligations to meet minimum requirements, typically in the area of corporate reporting. Especially in the supply chain context, participants' obligations have emerged as a key tool in strengthening the effectiveness and credibility of voluntary CSR initiatives. The continued growth of international CSR initiatives demonstrates both the private sector's interest in broader development issues, as well as the demand among global companies and investors for the kind of broad international voluntary frameworks that a multilateral setting can provide. Indeed, self-regulation can play a complementary (but not sufficient) role in pursuing social and economic objectives, and hence should be further encouraged and enhanced.

Coherence between international and national investment policies. An increasing number of countries is giving greater emphasis to investment regulation and the protection of legitimate public concerns (chapter III). Ensuring coherence between international investment policies and domestic policies is crucial. For example, a number of investor-state dispute settlement (ISDS) cases related to investment protection have touched upon countries' legitimate public policy objectives. Closely related are systemic considerations arising from the manner in which IIAs interact with domestic policies. Both IIA-driven or domestically-driven liberalization may have specific advantages and disadvantages (*WIR04*). The challenge lies in determining which combination of these best fits a country's policy and development context, to ensure that national and international policies reinforce and strengthen each other, ultimately fostering sustainable development.

Interaction between investment and other policies. Future policymaking needs to take into account the closer interaction between investment and other policies, including economic, social and environmental. A prominent example of these increasing interrelationships is the ongoing effort to reform the global financial system: the IIA regime needs to be carefully considered, as both regimes cover short- and long-term capital flows. Another example relates to industrial policies that deal with linkages and spillovers from investment, and the dissemination of technology (*WIR01*, *WIR05*). Besides economic policy, there is also a rising interrelationship between environmental and investment issues as manifested in, for example, the necessary incorporation of climate change considerations into investment policies, and vice versa (chapter IV). These interactions must be adequately addressed to create mutually beneficial outcomes and synergies between different areas of policymaking.

Investment for development: building a better world for all

The challenge for policymakers is to fully comprehend the depth and complexity of the TNC universe and its new interface with the State and other development stakeholders, as well as the sheer magnitude of the opportunities and risks arising from the nature of the policy challenges confronting the world community. Policymakers need to manage relevant TNC interfaces in a manner that maximizes the development benefits of TNC involvement, while minimizing the risks. Key interfaces include the following:

The interface between TNCs and poverty. Foreign investment needs to be encouraged and enabled towards the poor and marginalized at the bottom of the pyramid. It has to be nuanced appropriately to take into account a gender-differentiated and intergenerational approach. Investment can help create employment opportunities for the poor and marginalized, and also help improve their access to basic goods and services. It is crucial for the interface between TNCs and poverty to develop viable business solutions, so as to ensure that investing in the bottom of the pyramid is not a pro bono or philanthropic activity. Instead it should form part and parcel of a sustainable and beneficial business model. The evolution of the TNC universe and TNC strategies means that the patterns and pathways of their impact on development have changed, and they need to be better understood and acted upon.

The interface between TNCs and national development strategies has gained in prominence because of evolving TNC strategies and forms, and the revival of industrial policies. This nexus is especially crucial when critical development challenges, for instance, food security or climate change adaptation, are involved. Theoretical and practical issues arise, and must be addressed in the context of the wider interface between investment and development.

The interface between institutions and TNCs. Institutions, both formal and informal, have a significant impact on a country's ability to attract and benefit from foreign investment. In light of the importance of institution-building in facing globally critical issues, lessons need to be drawn on why in some cases countries are successful in building institutions and increasing the value derived from foreign investment, while in other cases they fail. Further attention needs to be paid by development partners to building institutions and enhancing their capacities.

Systemic challenge of investment for development. In the absence of a global approach to investment and development, the international investment relationship is governed by a highly atomized, multilayered and multifaceted regime, consisting of over 5,900 international investment agreements. Such a fragmented regime seriously lacks consistency between investment treaties, coherence between the national and international investment policies, and effective interaction between investment policies and other public policies. While countries continue to address these systemic challenges by fixing their individual investment regimes, the longer-term solution lies in a global approach to investment for development. Above all, the world needs a sound international investment regime that effectively promotes sustainable development for all.

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