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Attracting FDI and benefiting from it: challenges for the least developed countries

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Thank you, Mr. Chairman.

It is, indeed, a pleasure and privilege for me to attend this event, and I thank you for the introduction.

The topic of this event is very important – and I congratulate you for addressing it. It is important because all least developed countries (LDCs) need to attract FDI and benefit from it as much as possible in order to advance their development.

Actually, LDCs as a group are not doing that badly in terms of FDI inflows. The US$25 billion they attracted on average during 2011-2013 constituted about 2% of world FDI flows. But these US$25 billion amounted to about 13% of these countries' gross fixed capital formation. And that is a higher percentage than for any other country group. In other words, the FDI that LDCs received is more important for them than the FDI that other country groups received – although it is quite unevenly distributed among LDCs.

And while it is also true that most FDI in LDCs is in natural resources, an increasing share goes into manufacturing and services. Transnational corporations (TNCs) from all parts of the world, including those headquartered in such rising emerging markets as China, India, Malaysia, and South Africa, invest in the continent.

(Incidentally, outward FDI from African LDCs is rising as well, having reached US$4 billion last year. This indicates that some firms in a number of these countries have reached the international competitiveness that is needed to flourish in the world FDI market.)

These are encouraging trends. The international community needs to support them, precisely because FDI can make an important contribution to economic growth and development. The report of the Secretary-General before you lays out many options with respect to what support could be given.

In my opinion, the challenge is twofold:

1) To help **increase FDI flows** to LDCs; and
2) To **increase the contribution** that the FDI flows that LDCs receive make to the development of host economies.

Let me say a few words about these two challenges, starting with the first, namely how to increase FDI flows to LDCs.

As we know, FDI is undertaken by private firms (although state-owned enterprises are also becoming important) that have the capabilities to compete abroad and find it advantageous to do so through international production. Understanding *where* their FDI flows are directed requires that we look at the locational determinants of FDI. Three sets of determinants at the host-country end are particularly important:

- the economic determinants;
- the regulatory framework; and
- FDI promotion.

The most important factor for enterprises to undertake FDI in a country is the nature of the *economic determinants*: quality of infrastructure, size of the market, growth of the market, availability of skills, technological infrastructure, etc. If the economic determinants are not favourable for firms to make a profit, FDI will not take place. To put it differently: while the economic determinants are not everything, everything is nothing if the economic determinants in a potential host country are not favourable. The economic determinants are key for attracting FDI.

As we know, however, the economic determinants in LDCs are not favourable. They need to be strengthened, and official development assistance is critical for that purpose.

Naturally, FDI can only take place when the *regulatory framework* is enabling. There is no doubt that LDCs have made considerable efforts to improve this framework at both the national and international levels. But, of course, more can – and should – be done to make the enabling framework more welcoming. Let me mention only one practical example: individual LDCs could appoint Investment Ombudspersons, i.e., persons who have the confidence of the government and of the business community in a given country and, in this manner, could resolve conflicts in an informal manner before they escalate into disputes that are costly and disruptive for all. The Republic of Korea has had positive experiences with such an institution.

But, by and large, however – and this needs to be emphasized -- the regulatory framework for FDI is quite welcoming in LDCs. They are open for business. In fact, the FDI regulatory frameworks of LDCs are quite similar to those of other developing countries.

And that brings me to the third set of FDI determinants, *investment promotion*. Precisely because the FDI regulatory frameworks are quite similar across the developing world, investment promotion plays a particularly important role, and especially for LDCs. This is even more so because the economic determinants are typically better in the non-LDCs.

But Investment Promotion Agencies (IPAs) in LDCs are typically weak. They often do not have the capacity to target investors and follow-up with them once they have established themselves in a host country. After-investment services are particularly important: satisfied foreign affiliates in a host country are the country’s best ambassadors to encourage the reinvestment of earnings and bring in more FDI. Investment advisors who would work on a day-to-day basis with investors could be helpful. In short, IPAs need strengthening, and ODA could play a role here.

Therefore, the key for LDCs to obtain more FDI is to strengthen these three sets of FDI determinants.

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Getting more FDI is one challenge, *increasing the benefits* of the FDI that LDCs obtain is the second challenge. After all, countries do not attract FDI just for the sake of attracting it. They attract FDI to help as much as possible in their growth and development. This is a challenge often somewhat neglected.

Let me give two examples of how benefits can be increased:

The single most important mechanism to transfer the tangible and intangible assets and capabilities of foreign affiliates to domestic firms is through the mechanism of *linkages*, e.g., domestic firms becoming suppliers of foreign affiliates and, ideally, part of their global supply chains. Governments can institute linkage programmes in order to upgrade potential suppliers. Singapore is one of the countries that has done this successfully.

TNCs themselves can play a key role in that context by deliberately looking for firms in their host countries that could provide inputs at the right price and quality. They may need to overcome inertia to do that, but they can benefit from linkages as well, as sourcing locally reduces the vulnerability of their global supply chains. In other words, linkages are often in the own interest of TNCs, and governments can encourage the linkage-building process through various means.

Home countries, too, can do various things to enhance the contribution of their TNCs to the economic growth and development of LDCs. In particular, they can link the support they give to their firms investing abroad to certain conditions relating to the impact those firms have on their host countries. And a number of home countries do precisely that. For example, the Overseas Private Investment Corporation of the United States makes it a requirement that the projects it supports adheres to certain workers' rights enshrined in ILO Conventions. The Japan Bank for International Cooperation requires that environmental impact studies are undertaken before it supports FDI projects. The European Union has a similar requirement. Such home-country measures enhance the positive impact of FDI in host countries.

Another example of how host countries can improve the benefits they derive from incoming FDI involves *negotiating better contracts* with TNCs and other investors. This is particularly important in natural resources (and, as pointed out before, most FDI in LDCs is in natural resources), but it is also relevant for various infrastructure and other projects. Fair contracts are of key importance for host countries, as they determine the distribution of benefits associated with the projects involved for years to come. And well-negotiated contracts with TNCs and other participants for implementing large-scale complex projects make an important contribution to the self-financed graduation of LDCs from their LDC status.

Moreover, well negotiated large-scale, complex contracts between LDCs and TNCs can reduce the incidence of conflicts between host countries and TNCs, conflicts that are disruptive for both of them and, if they go to international arbitration, can be very expensive. In fact, between 1972 and mid-2014, some 30% of all cases before the International Centre for Settlement of Investment Disputes (ICSID) were linked to natural resources. If one adds infrastructure, an additional 30% of all international arbitrations are accounted for.

Unfortunately, though, LDCs typically do not have the multidisciplinary capacity required to arrive at the best possible contracts when negotiating with TNCs – they simply do not have the world-class negotiating teams required for that purpose. It is therefore very encouraging that the G7 is considering helping developing countries in this regard, and that LDCs supported this in their Cotonou agenda.

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Mr. Chairman, these are the two principal challenges LDCs face in the international investment field: attracting more FDI and benefiting more from it.

The examples I have given you show a number of ways how this can be done. The Secretary-General's report provides many more examples along these lines. All of them are worth considering, even though not every one might be the right thing to do for every LDC.

More importantly, however, I think that the proposal contained in the Secretary-General's report to launch an action plan for FDI in LDCs merits serious consideration. Implementing such a plan – which would be based on the coordination of various efforts already underway and enhance a number of them -- could make a tremendous contribution in terms of helping LDCs to *attract* more FDI and *benefit* more from it.

More specifically, and I quote from paragraph 72 of the Secretary General's report: "Greater coordination of such efforts can be achieved through a one-stop arrangement, such as an international investment support centre dedicated to the least developed countries." As continued in the next paragraph, "Such a mechanism would aim to fill the institutional gaps in providing coordinated support to least developed countries … without duplicating but complementing existing arrangements."

Mr. Chairman, I think implementing the conclusions outlined in the Secretary-General's report would be highly desirable if you wish to increase FDI flows to LDCs and the benefits associated with them.