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BOOK REVIEW

World Investment Report 2002: Transnational Corporations and Export Competitiveness

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For many years we have been accustomed to reports on the ever-increasing flows of foreign direct investment (FDI) and the continuous advancement of globalization. The annual World Investment Report, the most comprehensive and authoritative review of trends and patterns in globalization, came with a different message in 2002. A dramatic change has taken place worldwide, with FDI flows in 2001 recording their greatest downturn in at least 30 years.

The World Investment Report 2002 (WIR02) is important reading for researchers, policymakers and those who are just generally interested in where globalization is heading. Although it will take time to grasp the full scope of the recent variations in FDI flows, WIR02 already casts new light on what is under way at global, regional and national levels. Apart from statistical data, it offers a number of illustrative case studies examining the significance of transnational corporations (TNCs) to their host economies, especially as regards their export competitiveness – which is the special subject of this year’s WIR.

WIR02 demonstrates that the downturn in FDI concentrated mainly in developed countries (-59 per cent), with modest declines in the developing world (-14 per cent) and a slight increase in the economies in transition (2 per cent). It shows that, despite the slowdown, the significance of TNCs’ international production continues to grow – albeit at reduced pace – and the global activities of TNCs keep expanding. This is not least important for developing countries, where FDI remains by far the greatest source of financial, technological and skills transfers. On the other hand, WIR02 shows that FDI continues to be concentrated in a handful of developing countries, and seldom reaches the poorest ones. Forty countries receive an unchanged 95 per cent of the total allocated to the developing world. For the least developed countries, FDI remains considerably smaller than official development assistance.
WIR02 enters a daring exercise of trying to put numbers on the performance as well as potential of countries with respect to their attraction of FDI, which comes in the form of an “Inward FDI Performance Index” and “Inward FDI Potential Index”, respectively. The former compares the ratio of a country’s share in global FDI flows to its share in global GDP, whereas the latter is based on a set of economic and structural factors of relevance for foreign investors. WIR02 notes that these indices should be interpreted with care; they are not exhaustive, nor do they measure to what extent countries actually benefit from FDI. Indeed, while they do drive home the message that a country should pay attention both to its specific potential and to its actual ability to capitalize on it, they miss out qualitative aspects. More is not always better.

WIR02 underlines the significance of policies related to promoting export-oriented FDI, and points to the presence of partly contradictory trade and growth patterns in developing countries. Developing economies and economies in transition have displayed an impressive spurt not least in high-technology industries, but value added is relatively stagnant, reflecting a continued emphasis on simple labour-intensive operations rather than complex manufacturing or local research and development. For developing countries to attract and benefit from export-oriented FDI, a pro-active approach is needed that can help promote linkages between foreign affiliates and domestic suppliers, i.e. root TNCs better in the host country. For this to happen, WIR02 argues, policies must foster competitive conditions plugging into the appropriate “functional specialization” of the value chain.

In this context, a targeted policy approach to FDI promotion is recommended if host countries are to take advantage of the changing international production systems. On this point, WIR02 runs the risk of overstating the precision and effectiveness of Governments. It is important that policy should be based on a clear rationale, and on the anticipation that an intervention will enable positive externalities or other social gains that outweigh the risks and costs of the measure itself. At the same time, any successful strategy for promoting FDI inevitably requires a certain focus if scarce public resources are to be used sensibly. There is a fundamental need for Governments to improve their understanding of the opportunities and challenges of globalization, and WIR02 stresses that FDI policies must be consistent with the overall national priorities and strategies of a country.
Various issues related to the quality of FDI will require further work. The spurt in FDI over the last years primarily took the form of mergers and acquisitions (M&A) under conditions of greatly expanded room for manoeuvre for management relative to equity owners. A race for rapid positioning and exploitation ultimately unleashed bubbles and widespread failure. Developed countries, which were the prime battleground, subsequently found themselves in a downturn, pondering costs inflicted on them in their capacity as host as well as home countries. For developed and developing countries alike, conditions distorting the ownership and governance of firms, and messing up entrepreneurial and innovative efforts in society, may not necessarily show up in smaller FDI flows in the short term, although they are likely to lessen the presence of socially desirable transfers of competence and technology – and reduce the scope for long-term investment flows.

*WIR02* notes that the observed decline in FDI may lead to an intensified international specialization in investment as well as production activities. This may potentially carry huge social, economic and environmental consequences. The size and characteristics of FDI flows will greatly influence whether developing countries increasingly lag behind developed countries – and witness a widening knowledge, technological and progress divide – or whether they will be able to turn the tide and pursue more effective catch-up strategies than in the past. There are several impressive examples in *WIR02*, collected from highly diverse conditions, suggesting that success is feasible. Further work is needed to nail down how the conditions can best be put in place to enable a greater number of countries to attract and benefit from FDI in a way that can really help bridge the existing income and knowledge gap between developing and developed countries.

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