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Investment for Development

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"INVESTMENT FOR DEVELOPMENT"

Foreign Direct Investment throughout the world has dropped sharply, and yet transnational corporations continue to expand their role, reaching more countries, employing more people, and accounting for a greater percentage of world trade. How is that possible? How can the poorest countries attract the foreign investment they so desperately need? And what factors make an apparent economic basket case like Angola one of the potentially most productive countries for foreign investment? In this edition of **World Chronicle**, these questions are explored with the help of Karl Sauvant, Director of the Division on Investment for UNCTAD, the United Nations Conference on Trade and Development.

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ANNOUNCER: From United Nations in New York, an unedited interview programme on global issues. This is **World Chronicle.**

And here is the host of today's **World Chronicle**.

LITTLEJOHNS: I'm Michael Littlejohns, and this is World Chronicle. After a decade of growth, foreign direct investment throughout the world dropped sharply last year -- by 50 percent. Despite the global economic slowdown, transnational corporations have continued to expand their role, reaching more countries, employing more people, and accounting for a greater percentage of world trade than in the past. What does this mean for economies and societies across the globe? With us to analyze these trends is the principal author of the World Investment Report, Karl Sauvant. He is the Director of the Division on Investment, Technology and Enterprise Development for UNCTAD, the United Nations Conference on Trade and Development. Joining me to talk to Mr. Sauvant are Tuyet Nguyen of German Press Agency/DPA, and Thalif Deen of *InterPress Service*. Mr. Sauvant, welcome to **World Chronicle**. Mr. Sauvant it seems to be a slight contradiction in the fact that the foreign direct investment dropped very substantially yet international corporations, transnational corporations are still in there pitching, and have reached a higher involvement by far than in the past. How do you explain that?

SAUVANT: Well, I think Michael there are two main reasons that explain this. The first is that foreign direct investment flows, when we say that foreign direct investment flows drop, what we mean is that in the year 2000 investment flows were 1.5 trillion dollars, while in the year 2001 they were 735 billion flows. So in other words while flows were lower than the year before, nevertheless you had a substantial amount of foreign direct investment flowing across borders, which add to actually what the stock of existing foreign direct investment, and therefore add to the international production networks of increasing of transnational or multinational corporations. That is the first one. The second reason is that what you have increasingly is multinational corporations split up the production process and put the production of various parts and components or specific services in places where they can produce these parts and components or services best, and then trade them. So even if foreign direct investment flows should not increase at all by restructuring their international production networks in a way that you have an increased

intra-firm international division of labor, more trade is being generated within the framework of multinational corporations, and therefore the share of such intra-firm trade in total trade increases.

LITTLEJOHNS: Getting into specific countries, I noticed that Angola, which I thought, I think most people would think, it was an international basket case, what with the civil war, famine, terrible climatic problems, is one of the countries that was most attractive. Why is that?

SAUVANT: You are referring Michael to two new features of the world investment report 2002 namely the inward FDI performance index and the inward FDI potential index. The FDI potential index measures the actual potential of a country to attract foreign direct investment on the basis of a number of structured areas. The FDI performance index looks at the actual inflows of foreign direct investment over a three-year period and compares that to the gross domestic product of a country. Now using this particular index and looking at Angola, Angola comes indeed out on top of this particular index, and the reason is that Angola was very successful in spite of internal difficulties to attract foreign direct investment especially in the petroleum industry most of which is offshore. So in the light of this very specific natural resource related factor, Angola was very successful in terms of attracting foreign direct investment in relation to its total domestic product.

LITTLEJOHNS: So it was unaffected by the civil war?

SAUVANT: It was not unaffected by the civil war in the sense that if you hadn't had the civil war, chances are that Angola would also have attracted additional foreign direct investment in other areas like manufacturing and services. So with peace having established in Angola, I think the country has actually considerable potential to attract investment beyond natural resources.

NGUYEN: Is Angola doing better than other least developed countries in that sense? Has the index been applied to all of them? There are at 48 least developed countries around.

SAUVANT: This is actually a very important issue you are referring to, because traditionally it is assumed that the least developed countries of which are now 49 with the addition of Senegal, would not be attractive to foreign investors. What we find is that actually over a ten or fifteen-year period, quite a number of least developed countries have actually attracted foreign direct investment at a rate of increase of over 20%. Now this is, mind you this is on the basis of very low figures, but I think it shows that there is a considerable number of LDCs, least developed

countries, which actually offer business opportunities and which therefore ought to be exploited. But very often the problem is that the international business community considers least developed countries as basket cases, and therefore doesn't even look at investment opportunities. And therefore our message is to the international business community, you have to look country-by-country, industry-by-industry, project by project, to see whether there are investment opportunities, which the companies could utilize and of course the countries could benefit from.

DEEN: But don't you think that traditionally the poorer countries of the world, including the world's least developed countries, the foreign investors have always been reluctant to go in and there are some who argue that as a result poor countries are really being punished for being poor?

SAUVANT: Yes. I think this is a very important point; precisely because the countries are poor, international investors, and I am talking only about direct investors - I am not talking about portfolio investment - do not tend to look at these countries. They look at the more attractive countries like China, like Brazil, like India, and they don't look at the least developed countries. So in that sense they are being punished, and therefore I think the implication is that the international community has to make extra efforts in order to help least developed countries to attract and benefit from foreign direct investment. And for instance, UNCTAD is undertaking together with the International Chamber of Commerce a project in the frame of which we are preparing investment guides for least developed countries in order to draw attention to investment opportunities. Or we are undertaking investment policy reviews in order to help these countries to improve their regulatory framework. And all of that - let me please add that - is not meant to say that for the least developed countries in particular Official Development Assistance remains of crucial importance simply because they are poor, and because they do not attract as much direct investment as they would like to.

LITTLEJOHNS: But in most of these countries, Mr. Sauvant, the infrastructure is very seriously lacking, therefore they are not very attractive for foreign investment. How are you going to get around that?

SAUVANT: Well, I think you just made a case for Official Development Assistance and the need to indeed increase Official Development Assistance to the least developed countries, so that the infrastructure is being improved from which not only foreign investors would benefit, but domestic investors. And we should always keep in mind that foreign direct investment is

really only a compliment to domestic investment. So Official Development Assistance can help in this respect to improve the business climate and make it more attractive for domestic and foreign investors to invest in these developing countries.

DEEN: If you want to single out the most important or the most attractive factor of foreign investors, would it be political stability or economic liberalization?

SAUVANT: We distinguish three sets of factors as determinants for foreign direct investments. The first set concerns the regulatory framework. The regulatory framework can be decisive if a country says I don't want foreign direct investment, I forbid foreign direct investment to come in. But once you have a regulatory framework, which is broadly speaking enabling, other and most countries are seeking to have one, in fact all countries are seeking to have an investment framework that is enabling. Then two other factors come in to play. The first one is that countries undertake increasingly active promotion in order to attract foreign direct investment and have for instance established investment promotion agencies for that purpose. But the most important single factor, or set of factors, concerns economic determinants. The bottom line is unless foreign investors can make a profit, they are not going to go into a country, and therefore the economic determinance, the size of the market, the growth of the market, the quality of the infrastructure, the quality of the skills are increasingly the single most set of factors that attract foreign direct investments.

NGUYEN: The United States has remained the largest recipient of foreign direct investment. I wonder if based on what you just said about the three points, has the US made all those three requirements to attract so much for direct investment even since the September 11th attacks in the year 2001, it has continued to get all the money.

SAUVANT: Well, the US scores in terms of our inward investment potential index, actually on top of that index. In other words, as a country that has the biggest potential to attract foreign direct investment, the reasons are well known. Indeed the regulatory framework is very enabling, although the country doesn't have one investment promotion agency, most of the states have investment promotion agencies and actively seek to invest, seek to attract foreign direct investment, especially from Europe and from Japan. And of course economic determinants in terms of size of markets, skills, research and development capacity, technological capacity is extremely good. So all of this makes this country, makes the US a very attractive location for foreign direct investment. The September 11 events did not really change that very much. We

had done a survey just before September 11 of the year 2001 in order to see which are the most favored investment locations and what will happen to future investment. And then we did an additional survey immediately after September 11, and we found that not much has changed for international business in general. And the reason is really that the underlying factors driving the expansion of foreign direct investment, driving the expansion of multinational corporation haven't change, which is the liberalization of investment regimes, which open new spaces for foreign direct investments; the technology, which allows you to create international production networks, and the competition of firms to actually utilize the space and possibilities, in the interest of their own competitiveness. So a portfolio of locational advantages is becoming an important source of competitiveness of individual firms.

LITTLEJOHNS: This is World Chronicle. Our guest is Karl Sauvant, Director of the Division on Investment Technology and Enterprise Development for UNCTAD. Mr. Sauvant, as we record this programme, the possibility of war with Iraq is very serious. Has UNCTAD done any analysis of what effect on developing countries and on foreign direct investment might come out of such a conflict?

SAUVANT: We have not. The only thing I can say in this context is that of course any conflict, be it civil war or international war in any particular region, is not a factor that encourages investment be it domestic or foreign. But we have not looked specifically at the situation in Iraq.

DEEN: Tell me, if the world's poorer countries are given a choice between increased foreign direct investment and increased foreign trade, what should they opt for?

SAUVANT: That is a very interesting question. I think we have actually arrived at a state in the multilateral trading system that many of the developing countries, and in particular the least developed countries to which you refer, actually have fairly open access to the markets of the developed countries in the context of the everything but arms initiatives, the Lome Convention, and then the Caribbean Basin Initiative, and other initiatives. So in many ways, the markets are open for most products of developing countries. There are some important ones for which they are not open: textiles, or not as open as they should be, textiles, agricultures and some others. So the issue is for the least developed countries in many respects, not so much market access but the ability to actually utilize this market access, in other words the bottle neck is increasingly supply capacity of least developed countries to take advantage of the

opportunities created by a liberal multilateral trading system. So the answer to my question is I think for the least developed countries in particular, but I would argue for many developing countries, the challenge becomes increasingly to strengthen their supply capacity in order to take advantage of the international trading system. And foreign direct investment has a role to play in strengthening this supply capacity.

NGUYEN: Mr. Sauvant, many African leaders have adopted a new economic partnership - I think it is called NEPAC –

SAUVANT: Yes.

NGUYEN: Economic Development for Africa. I wonder - you know – that plan , is this better than all the UN plans adopted by the General Assembly, which have been scrubbed in favor of the new plan? I wonder if that plan can work the way you – based on what you said – will work if they apply all these criteria?

SAUVANT: Well, I think NEPAC; this new plan for Africa has two distinctive features. The first one is, it is really a plan, which was not adopted by the General Assembly, but it was formulated by the African Union. So it is really an indigenous plan. And if you look at it, secondly, it is really the only plan on a continental level that exists. There is no similar type of thing for Asia or for Latin America which I think indicates that African leaders have recognized that they have to take a common approach and the willingness to cooperate and in the framework of this plan, they are addressing a whole set of issues: political issues, economic issues, social issues. Now in the economic area, and in particular in the context of foreign direct investment, as I mentioned earlier, market size is an important determinant to attract foreign direct investment, and to the extent that in the context of NEPAC it is possible to create for instance bigger market and stimulate growth, I think it makes it also more attractive for domestic and for foreign investment to engage themselves in Africa.

NGUYEN: What has been the reaction from transnational corporations, with regard to NEPAC and the FDI toward it?

SAUVANT: We had actually as it happens in the world summit, in Johannesburg in the beginning of September 2002, an event in the framework of which we brought together in the context of an investment advisory council and a round table organized by the global compact, the opportunity to bring together business people and government people to look specifically at the possibility of stimulating sustainable investment in Africa. And certainly the

signal we have received from the business community is that indeed there is potential for more investment in the business community or a number of companies are indeed interested in pursuing these opportunities. So we have to see whether indeed in the follow up of the Johannesburg Summit, we can come up with a mechanism in the framework of which we can support, we can encourage sustainable investment in Africa.

DEEN: Your report says that many developing countries are trying to undercut each other by offering incentives to foreign investors. Is this a common trend?

SAUVANT: This is a very important issue. The 2002 World Investment Report focuses specifically on the question of attracting export-oriented investment. If all countries are pursuing, practically all countries, are pursuing an outward oriented development strategy, in that context of course investment that can help to reach a world market place is particularly important. And, as we have documented in the report, multinational corporations play a pervasive role in exports of developing countries and other countries and in particular in those countries, which have gained the biggest market shares over the fifteen years, multinational corporations in one way or another have played a key role. Now in attracting such export oriented investment, the competition for such investment is particularly strong. And countries are increasingly using incentives in order to attract investments. And these incentives cannot only be of a financial and fiscal nature, they can also consist of regulatory incentives, which means regulatory competition in the framework of which perhaps standards could be lowered. So we are drawing very much attention to the fact that the lowering of regulatory standards is not a way to attract foreign direct investment and countries should avoid it, and at the same time, we are raising the question whether in particular financial incentives competition is in all instances to the advantage of the developing countries, because typically in such a competition the developed countries have deeper pockets than developing countries in order to pay incentives to attract foreign direct investment.

LITTLEJOHNS: Mr. Sauvant, the UNCTAD was established in 1964, around the slogan, 'trade not aid.' I happened to attend the opening session in Geneva as a correspondent at that time. Would you say that the experiment, if we may call it that, has been relatively successful? Because you have had some ups and downs in UNCTAD. There was a crisis of confidence a few years back, but you have seemed to have recovered. How does it look now?

SAUVANT: Well, I think every institution; every national, regional and international institution always have to demonstrate that it has indeed a useful role to play in the broader context of things. And of course the particular role of UNCTAD is to look after the interest of developing countries and to promote the interest. This has been done in the context of trade issues. It is now being done also in the context of investment issues, where actually UNCTAD is a focal point within the UN system on matters related to investments, and it is also done in the broader issues of for instance globalization and development strategies, the framework of which developing countries can gain most for the development efforts. So I think the importance of UNCTAD as an institution that assists developing countries, that provides alternatives to existing approaches to promoting development, and that helps developing countries in the context of increasing trade and investment, is perhaps more important than ever because all countries are pursuing an output oriented strategy, and in that context it is important that indeed they are best advised and informed about what the issues are relating to trade and investment or globalization in general.

NGUYEN: Mr. Sauvant, the number of least developed countries have actually increased, not declined. I wonder if the UN has been successful at helping developing, or less developed countries?

SAUVANT: I think that you are right, the number of LDCs have increased. In fact Senegal was just added to the group. I think what this means is that we have to recognize that the effort to help especially the least developed countries to develop and to develop fast is really a very difficult effort and it is a longer-term effort. It is not something we can evaluate in one or two years or even one or two decades. And I think the Millennium Development Goals in this respect of the United Nations are particularly important because they help to focus the attention and the resources of the UN system, and for that matter the world, on particularly the development of developing countries, but in particular the least developed countries.

DEEN: What is the relationship between foreign investment and globalization?

SAUVANT: Well in many ways you could argue that foreign direct investment and the establishment of an international production system is the productive core of a globalizing world economy, because as production systems of countries are growing together, and as , as Michael mentioned earlier, one third, or maybe 40% of world trade is actually intra-firm trade,

and as a number of movements of skills and technology takes place in the context of international production system, that really is, if you want, the driving motto of the globalization process. And I think it makes it all the more important to look at this phenomenon and look at it not only from the point of view of how it is growing, but how it can be harnessed for the development objectives of developing countries. That is precisely one of the reasons that, in the context of the World Investment Report 2002, we are looking at targeting export oriented FDI as a means to increase the trade performance of developing countries, and of course, as a tool, to advance the development.

LITTLEJOHNS: And you are also going to add, I saw, a section on corporate social responsibility, which of course will be highly topical. It is highly topical now and probably will be just as topical then. But, unfortunately that is all the time we have. Thank you for being with us on this edition of World Chronicle. Our guest has been Karl Sauvant, Director of the Division on Investment Technology and Enterprise Development for UNCTAD, the United Nations conference on Trade and Development. He was interviewed by Tuyet Nguyen of the German Press Agency/DPA, and Thalif Deen of InterPress Service. I'm Michael Littlejohns. Thank you for joining us. We invite you to be with us for the next edition of **World Chronicle**.

ANNOUNCER: Transcripts of this programme can be obtained free of charge by sending a self-addressed, stamped envelope to **World Chronicle**, United Nations, Room S-827L, New York, N.Y., 10017.

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