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How to Prime the FDI Engine

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Continued on page 4

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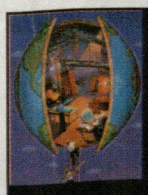

How to Prime the FDI Engine

BY KARL P. SAUVANT

COUNTRIES WITHOUT TRADITIONAL ADVANTAGES ARE LEARNING TO "CREATE" ASSETS. —KARL SAUVANT

The sharp declines in international short-term portfolio equity investments and the shrinking of the international bond market have distorted the picture of globalization. Despite a world in financial turmoil, foreign direct investment from transnational corporations in 1998 likely will rise by about 10% from the previous year to around $430-440 billion—better than double the annual volumes recorded at the start of this decade. The growth in FDI is coming in all regions of the world. Further, the value added by foreign affiliates of transnationals now accounts for more than 7% of the global domestic product. There is no doubt that foreign direct investment is a prime engine of globalization; indeed it is the productive core of globalization.

Moreover, looking beyond the numbers reveals long-term trends that are decidedly positive. The 1997 and likely 1998 FDI increases reflect the basic stability and long-term perspective of corporate investors, in contrast to the far more volatile nature of short-term portfolio flows. The number of transnational corporations is growing, as is the number of their foreign affiliates, and the largest TNCs are becoming still more transnational.

It seems increasingly evident that cross-border M&A will play a rising role in FDI, and as a prime driver of globalization. A prevailing strategy of today's multinational corporation involves divesting non-core businesses and strengthening competitive advantages through strategic acquisitions. A consequence may be greater concentration in the hands of a few companies in each industrial sector. Majority-owned cross-border mergers accounted for $236 billion of 1997 foreign direct investment, rising to 60% of all FDI from a level of just below 50% in 1996.

We are also discovering key shifts in site location strategies of larger global corporations. Traditional factors determining where TNCs invest remain important—companies still look for a hospitable investment environment, opportunities to exploit natural resources, low-cost labor, and the chance to access a growing and large market. But, increasingly, companies are pouring money into locations that offer what we call "created assets." These man-made advantages range from infrastructure to sophisticated labor skills, such as managerial and technological know-how.

As the search for created assets becomes more central to a company's foreign investment strategy, countries without traditional advantages have become competitive in attracting FDI. Take Costa Rica, for example, which created assets, including skilled labor, that attracted a $500 million investment from Intel in 1997.

The forces of trade and investment liberalization, deregulation, and privatization are combining with the mounting international ambitions of business to stimulate FDI growth. We do not see the tempo slipping. We do see the sophistication of corporate leaders toward FDI rising.

We also see governments moving with gathering speed to respond to the competitive needs of global companies. We see them adapting their national policies to favor education and infrastructure development and, as a result, becoming more attractive to long-term foreign investors. Concerns that have arisen in developing countries about the desirability of short-term portfolio investment inflows may serve to heighten the interest of governments in becoming still more attractive to long-term direct investors.

Dr. Sauvant is chief of International Investment, Transnationals, and Technology Flows at the United Nations Conference on Trade and Development in Geneva. The World Development Report 1998 was published in November.

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