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OECD Global Forum on International Investment

NEW HORIZONS FOR FOREIGN DIRECT INVESTMENT

*Introduction, Synthesis of Conference
Deliberations and Chairmen's Conclusions*

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The OECD's Global Forum on International Investment (GFII) held its inaugural conference "New Horizons and Policy Challenges for Foreign Direct Investment in the 21st Century" in Mexico City, 26-27 November 2001.

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INTRODUCTION,

William Witherell,

Director, Financial, Fiscal and Enterprise Affairs, OECD

The title for this conference is “*New Horizons and Policy Challenges for Foreign Direct Investment (FDI) in the 21st Century*”. I hope that the outcome will make clear that the word “new” in the title is justified – that the international investment policy scene is a dynamic one, with important developments that need to be taken into account by all interested parties: host and home countries, multinational enterprises and their providers of finance, representatives of the workers, NGOs and the multilateral organisations.

We are fortunate to have speakers highly qualified to help us identify emerging trends and policy challenges and to evaluate alternative approaches. But it is the active participation and the open discussions between conference participants, which produce the open and inclusive dialogue that we hope will be the trademark of this and future events of the OECD Global Forum on International Investment (GFII). It is our hope that the discussions and conclusions of this conference will contribute to the forthcoming UN International Conference on Financing for Development, scheduled to take place in Mexico, in March 2002.

Many of us in the international investment community feel the need to come together to exchange information, views and ideas on emerging issues in an open and inclusive dialogue. This Forum aims to provide such a platform for all stakeholders and players in the field of international investment. The GFII and seven others, created in 2001, aim at deepening and extending relations with non-OECD members and other dialogue partners in fields where the OECD has particular expertise. Our aim in doing so has been to create venues for discussing issues that require global solutions. This inaugural conference of the GFII represents an important step in this direction.

The high interest in this Forum is evidenced by so many of you making the effort to participate, many travelling long distances to do so. This suggests to me that most if not all present would agree that FDI is now needed more than ever, particularly in the current juncture of the world economic slowdown and the international drive to advance the development and poverty reduction agenda. Indeed, I would argue, FDI is not only a mainstay of development; it also contributes to an environment conducive to international peace and solidarity as well.

Many countries are making efforts to attract more FDI. Increasingly, FDI has been recognised as a powerful engine and a major catalyst for achieving development, poverty-reducing growth and global integration process. Unfortunately, many low-income countries have not benefited from the international investment surge. They have lagged behind in terms of pursuing policies and institutions conducive to their integration in the world economy. Indeed, some areas of the world have been excluded from any of the benefits of globalisation. Intensified efforts are hence needed to foster FDI worldwide. This is especially important for countries and continents such as Africa, which so far have attracted little FDI.

The new technologies, managerial practices and financing techniques of business operations have considerably changed the environment and decision-making process for international investment. At the same time, larger FDI flows also create new challenges to policy makers in host countries, in particular to preserve the capacity to pursue — in a non-protectionist and non-discriminatory way — its own social and environmental objectives.

But we believe that, in general, the best response to this challenge lies in strengthening the environmental and social safeguards, rather than in limiting FDI flows and foregoing the economic benefits that these carry with them. Ensuring that foreign and domestic investment policies and national environmental and other relevant policies remain mutually supportive raises new challenges for governments. A rethinking of some traditional approaches to FDI is underway.

It is no longer sufficient for a country simply to liberalise its restrictions on FDI - most have already done so. Nor is offering expensive tax and other incentives the key to success. Rather, attention should be given to a broader set of policies and institutions, starting with the provision of national treatment, reduction of bureaucratic red tape and a fair and predictable tax system, but including such other policy areas as education, public and corporate governance, the rule of law, anti-corruption, competition policy, property rights, sanctity of contracts, protection of intellectual property, and so on.

A related challenge is how best to maximise the benefits of FDI in ways that do not deter the investment flows in the first place. This requires a better understanding of the various effects of FDI - both positive and negative - and how they work. A number of the speakers will present the latest analyses addressing aspects of this issue. It will be evident from the discussion, I believe, that in developing an enabling environment that will enhance the location's attractiveness to foreign investors, a country will also be adopting those policies and creating those institutions that will help it maximise the net benefits of FDI and of domestic investment as well.

Host countries are not alone in this endeavour of capacity building; home countries, companies, multilateral organisations and civil society groups all share responsibility. There is an acute need to work together in an effective and coherent way towards FDI capacity building in host countries, whether bilaterally, regionally or through multilateral organisations such as the OECD, the World Bank Group, WTO, UNCTAD or other relevant regional/international organisations. International co-operation and the sharing of experience can help all our governments to learn from each other what the "best practices" in the field of FDI are.

For its part, the OECD is actively engaged in open dialogue and experience sharing beyond its membership. Since its creation, the OECD has been at the forefront in developing "rules of the game" for international investment and multinational enterprises.

Today, six non-member countries (Argentina, Brazil, Chile, Estonia, Lithuania and Slovenia) have adhered to the OECD Declaration on International Investment and Multinational Enterprises, a political agreement providing a framework for co-operation on a wide range of investment issues. As a counterpart to their commitments under this instrument, non-member adherents participate in related OECD work. The adherence of Israel, Latvia, Singapore, and Venezuela is in the process of being negotiated as of this date. Our 2001 Ministerial Council Meeting has called on the OECD to invite other interested non-member countries to adhere to the Declaration.

The need for co-ordination and participation of many donors and international institutions in the field of international investment is particularly important. The World Bank, UNCTAD, UNIDO, IMF, Inter-American Development Bank, European Commission are all represented at the conference, and I

feel there is a great deal of synergies to be achieved among us in our future work on foreign direct investment.

In this respect, the OECD welcomes the results of Doha and pledges its full support for follow-up work in the context of the WTO. Together with other international partners, we will contribute to deliberations on how multilateral organisations could help promote FDI in support of sustainable development.

As we enter into this dialogue we should bear in mind several international events to which this meeting could contribute. The first, which is rapidly approaching, is the UN International Conference on Financing for Development that will take place in Mexico in March 2002. Second, the recent Doha Conference has raised the prospect of negotiations on FDI commencing in the WTO in several years if the necessary consensus can be achieved. The issues discussed during the two days of this inaugural conference of the OECD Global Forum on International Investment will be very relevant to both of these processes. It goes without saying that the OECD will continue its efforts to foster open and inclusive dialogue on international investment issues with all the relevant stakeholders.

SYNTHESIS OF CONFERENCE DELIBERATIONS

Plenary Session – New Approaches and Opportunities for Development.

In launching the discussion, the Plenary Session Chair, *Mr. William Witherell* of the OECD, stressed that FDI was needed “more than ever”. FDI is recognised as a powerful engine and major catalyst for development, poverty-reducing growth, and the global integration process. The Chair regretted, however, that many Developing Countries and Least-Developed Countries had received only small amounts of FDI. This situation highlights the need for host countries to have a broader set of policies and institutions in order to attract investment and to maximise the benefits of FDI. In this task, home countries, multinational enterprises, international organisations, and civil society organisations have a shared responsibility.

Mr. Hernando de Soto of the Institute for Liberty and Democracy focused his presentation on the importance of “property rights” and the Rule of Law. In his opinion, trust is “the enabling environment for investment” and is an internal task of developing countries. Mr. de Soto presented the results of several studies he had conducted on the “underground economy in the developing world” that showed that the assets of poor citizens are not as low as they are believed to be. The challenge, therefore, is to bring those assets from the “extralegal” sector into a more inclusive legal property system in which they can become more productive and generate capital for their owners.

To illustrate this challenge, the speaker presented the experience of a Latin American country [Peru] when its government tried to sell the national telephone company. The company had been valued on the local stock exchange at US\$53 million, but the government had been unable to sell it to foreign investors due to the company’s title to many of the assets. In order to solve this problem, a legal team created both a title of the company’s assets and a dispute settlement procedure, which gave legal certainty to third parties. Three years later, the same telephone company was sold at 37 times its previous valuation in the stock exchange. In concluding his presentation, Mr. de Soto stressed the importance of “thinking and focusing on law”.

In his presentation, *Recent FDI trends, implications for developing countries and policy challenges*, *Mr. Karl Sauvant* of UNCTAD explained that before the tragic events of 11 September, UNCTAD had calculated an expected decline of world FDI flows in 2001 of 40 per cent. This decline is related to the slow-down of the world economy and to the sharp drop in mergers and acquisitions (M&As) activity, but is expected to be further accentuated as a result of the above-mentioned events. These events increased the level of uncertainty, which will probably make some companies put planned investment on hold. The impact is likely to be uneven, affecting specific sectors and host countries in different ways.

The decline in M&A’s activity is likely to be more significant, (but the underlying determinants of M&As still suggest that this mode of FDI entry will continue on an upward trend in the longer run). Other possible impacts of the accentuation of the economic slowdown could be the relocation of

certain facilities in order to reduce costs, and modifications to regulatory regimes in order to attract FDI through the liberalisation of some sectors. Having explained the recent trends in FDI, Mr. Sauvant underlined the need to restore confidence among consumers and investors, and proposed some responses to the decline in FDI.

The first response should be investment promotion (through three different “generation” policies).

- *First generation policies:* the liberalisation of FDI flows and the opening-up of sectors to foreign investors.
- *Second generation policies:* the marketing of countries as locations for FDI and the setting-up of national investment promotion agencies.
- *Third generation policies:* The targeting of foreign investors at the level of industries and clusters, and the marketing of regions and clusters with the aim of matching the locational advantages of countries with the needs of foreign investors.

The second response to the decline in FDI would be the optimisation of the benefits from FDI (capital inflows, employment, information, technology and knowledge transfers, access to international markets, competition). These benefits do not, however, accrue automatically. In order to reap the full benefits of FDI, there is a need to promote linkages with the domestic economy. Such linkages are a positive approach and a “win-win-win” situation, because they have potential benefits for foreign affiliates, local firms and host countries.

In concluding his presentation, Mr. Sauvant mentioned some lessons learned from “best-practices” in linkage promotion (political commitment; collaboration with the private sector; selectivity; focus on the upgrading of local supply capacity; identification of areas of intervention, such as matchmaking, information, technology, training, and financial assistance) and emphasised the need to focus on policies because “policy matters”.

Paul Laudicina introduced the results of a survey conducted by the AT Kearney’s Global Business Policy Council “to inquire about post-September 11th investment intentions and attitudes of Global 1,000 senior executives”. [The participant senior executives came from 17 countries and 14 specific industries]. The events of September 11th had an impact around the world, increasing the investment community’s reluctance to expand (in particular to conduct M&A’s transactions) and affecting consumer confidence. The main findings of the survey are listed below:

- More than nine out of ten CEOs are more negative about global economic conditions today compared to a year ago, and none feel more positive.
- Almost one out of three CEOs has a more negative outlook of the United States as an investment location.
- China experienced a positive shift in investor outlook over the survey period, with close to 15 per cent of executives reporting more positive perceptions of it.
- On future investment plans, 64 per cent of the CEOs intend to maintain approximately the same levels of future foreign investment as planned. However, a greater percentage of executives are inclined to reduce investments rather than to increase them.
- Geopolitical considerations have re-emerged as important factors affecting senior executive FDI calculations.

The conclusion of the survey is that “executives express increased pessimism and uncertainty about the state of the global economy. Nonetheless, they have adopted a “steady-as-you-go” approach toward the implementation of their already substantially reduced plans for investments abroad”.

The first panelist, **Ms. Olivia Jensen** of Consumer Unit & Trust Society, India, focused on the strategy implemented by South Africa in order to attract FDI flows, and on its results. The panelist explained that, in spite of South Africa’s “third generation” policies, it had not been able to attract the desired levels of FDI. This can be explained by the lack of confidence as a result of crime rates, AIDS, and regional instability. Regarding the Indian case, the panelist explained that India is conducting a gradual liberalisation process, but a significant amount of restrictions still remain.

Such restrictions exist in agriculture (where there is no FDI), in telecommunications, and in textiles (reserved to small-scale industries). Other relevant factors in the Indian case are bureaucracy and the slow pace of reform (whose agenda encounters resistance from civil society and domestic business). In concluding her presentation, Ms. Jensen recommended that countries: develop clear views on the kind of investment they want to attract (focusing on quality and not only on quantity); set strategic targets; co-ordinate policies across different branches; and build political consensus in their domestic constituencies.

Mr. John Evans, of the Trade Union Advisory Committee to the OECD, presented *The Trade Union Perspective*. At the beginning of his presentation, Mr. Evans mentioned the competition for FDI, and in particular the delocation of investment. To illustrate this subject, he referred to a press article, which mentions an investment in [Mexico] [one country] which delocated to [China] [another country] because of the low costs in the latter. The panelist also stressed the need for the respect of core labour standards, and for good governance consistent with both good economic performance and good export performance. Consistency is therefore the main policy challenge, and could be achieved through: a skilled labour force, productivity, good infrastructure; a “race-to-the-top” (as opposed to a “race-to-the-bottom”).

Furthermore, Mr. Evans identified some messages to be conveyed to the United Nations Conference on Financing for Development: There is a need for an effective legal structure (to bring workers from the informal sector into the main stream of society) and for social safety nets; Official Development Assistance (ODA) is a priority for Least-Developed Countries; international rules (property rights) and respect of human rights are needed; on this last issue, he mentioned the issue of Burma. In closing, Mr. Evans referred to the “User Guide” to the OECD Guidelines on Multinational Enterprises, prepared by TUAC, and in particular, to the worldwide implementation of those Guidelines. He called for immediate action in the present situation because of the pressure on standards and on conditions.

The main topic discussed in the presentation by **Mr. Ernesto Stein**, of the Inter-American Development Bank, was whether the benefits of FDI for the host countries depend on the manner in which FDI is attracted to a country. Mr. Stein’s presentation focused on the factors influencing FDI location, and placed special emphasis on the role played by the quality of host-country institutions as a determinant of the location of FDI. He mentioned several variables such as the extent of bureaucratic red-tape, political instability, corruption and the quality of the legal system, and their relationship with other variables like attitudes toward the private sector, the living environment, inequality, the risk of terrorism, etc.

Mr. Stein took a closer look at FDI flows in Latin America to see how it compares with other regions in terms of success in attracting FDI, to identify the countries that have been more successful in this regard, and to trace where FDI flows to Latin American countries originate. He also explored the role of institutional variables as determinants of the location of FDI, using a large number of variables

drawn from several different sources (e.g. Kaufmann's government indicators, data and empirical strategy, gravity models, explanatory variables, ICRG variables).

Finally, Mr. Stein concluded that the quality of institutions has a positive effect on FDI. In particular, he stressed that market-unfriendly policies, excessive regulatory burden, and lack of commitment on the part of the government seem to play a major role in deterring FDI flows.

Mr. Jorge Roldos of the International Monetary Fund outlined the most important structural changes in the financial systems of emerging markets and their effects. FDI and portfolio investment have increased the foreign ownership and control of emerging markets' banking systems. Some factors that explain the increase in FDI in emerging markets' banking systems are the globalisation of the financial services industry and the removal of barriers to entry in several of these countries. A number of recent studies of the efficiency and the stability effects of foreign bank entry have also been conducted.

Foreign bank entry can contribute to the efficiency of the banking system through improved evaluation and pricing of credit risks and enhanced availability of financial services (there is empirical support for emerging markets but not for mature ones). Foreign bank entry can also contribute to the stability of the banking system through improved diversification, a stable credit and deposit base, and parental support (although there is broad empirical support for the first two factors, this is unclear for the last one). The panelist stressed that the growing presence of foreign banks has raised some policy issues – such as cross-border supervision and regulation, banking system concentration and systemic risks, and social safety nets – that require attention.

Panel A – Benefits of FDI for Development: Country Experiences

Chaired by **Mr. Neil Roger** of the World Bank Private Sector and Foreign Investment Advisory Services, and reported by **Mr. Jan Schuijjer** of the OECD, this Panel focused on the role of FDI in promoting development and poverty alleviation.

Mr. Luis De la Calle Pardo, Mexican Vice-Minister for International Trade Negotiations, spoke about *The importance of FDI in the Economic Development of Mexico*. Mr. De la Calle divided his presentation into two specific issues: i) the benefits of FDI, and ii) the challenges for the future. On the first point, Mr. De la Calle stressed the preferential access that Mexico has to 850 million consumers in 32 countries through its large network of international agreements. Mexico already has in place 11 Free Trade Agreements (FTAs) and has negotiated 19 Bilateral Investment Treaties (BITs). In addition, Mexico is negotiating BITs with three more nations: the United Kingdom, Japan and Israel. The importance of Mexico's participation in international organisations such as the OECD was also highlighted.

Mr. De la Calle explained how trade and investment openness have benefited Mexico:

- Mexico is the 8th largest exporter in the world and the largest in Latin America
- Export activity is the main source of Employment in Mexico
- Mexico is the third-largest FDI recipient among developing countries.
- Since NAFTA, the annual average of FDI received by Mexico has more than tripled.

- More than 20 per cent of formal employment is located in FDI firms. FDI has allowed employees to be incorporated into the formal labour sector of the economy, which, in fact, enhances their quality of life.
- Employment growth rate in firms with FDI is higher than the domestic average. To date, FDI firms have created half of all new jobs generated in Mexico.
- Firms with FDI pay better than the domestic average (around 50 per cent higher).

He affirmed that Mexico is certainly an attractive destination for FDI: around 84.6 per cent of FDI comes from the United States, 10.3 per cent from the European Union, 2.8 per cent from Canada, and 2.3 per cent from other countries.

On the second point, “challenges for the future”, Mr. De la Calle explained that even when 94 per cent of Mexico's exports have duty-free access by 2003, there will be decreasing returns of market access. In this regard, Mexico could have to attract investment of better quality to compensate. In addition, Mexico has to face hard competition. Its main competitors come from Asia and Latin America (Chinese Taipei, Korea, China, Brazil).

Mr. De la Calle concluded that only by maximising its fundamental comparative advantages will Mexico be able to deepen the benefits of economic openness. That is to say, Mexico should take advantage of its young population, privileged geographic position and network of FTAs to become an investor in human capital, modernise its infrastructure, and diversify trade in order to address the relative preferences.

Finally, the Panel found that it is very important that FDI be a catalyst of added value in the export processes of a country. In order to attract FDI the return-risk combination should be enhanced by seeking to decrease costs and giving legal security and predictability to investors and their investments.

Ms. Melek Us, Director General of Foreign Investment, Turkey, introduced her paper *Removing Administrative Barriers to FDI: Particular case of Turkey*, by discussing the weaknesses and strengths of Turkey and the actions taken by the government to transform Turkey from an economy lacking competition and efficiency, into an attractive destination for FDI. By establishing ambitious programmes to dismantle administrative barriers, and setting immediate measures to promote investment, Turkey is now becoming a stronger economy. All of these measures are based on a comprehensive dialogue between the government, the private sector, academics and other interested parties.

FDI and its Impact on Employment and Social Policies: The Malaysian Experience was the theme of **Mr. Govindasamy Rajasekaran**, Secretary General of the Malaysian Trades Union Congress. Mr. John Evans of TUAC delivered his presentation since Mr. Rajasekaran was unable to attend. Focusing on the case of Malaysia, the impact of FDI on many elements of labour policies was emphasised. First, it was stressed that even if FDI does help to create jobs, it does not automatically lead to a better standard of living for workers.

The limits of FDI to growth were explained. While the large inflow of foreign investment can be effective in reviving the economy, it is not a long-term solution to economic development. It has to be accompanied by domestic developments such as the transfer of technology to local firms, the development of local production capacity and sourcing of inputs, and the development of local human

resources. For a country with a small population like Malaysia, inviting labour-intensive foreign investment creates a tight labour market that threatens to increase labour costs.

It was concluded that:

- In Malaysia the birth and growth of trade unions are severely restricted.
- Multinational enterprises, mainly from OECD countries, exert a great deal of pressure on the Government to successfully ensure that independent industrial unions are not permitted.
- Respect for freedom of association is central to the attainment of economic development and sustainable growth.
- Trade Unions play an essential role in the development process by achieving a sustainable distribution of income and wealth.
- Productivity, growth, and development all depend upon a generalised perception that the labour market is equitable.

Ms. Anabel Gonzalez, Director of the Costa Rica Investment Board (CINDE), introduced the topic *Key Drivers for Investing in Costa Rica: the Intel Case*. First, Mrs. Gonzalez gave a general description of Costa Rica: location, area, population, GDP, exports, imports, and amount of FDI. Then she explained the criteria used by Intel to select the country to establish its plant. These include stable economic and political conditions, adequate human resources, a pro-business environment, logistics and manufacturing lead time, and a fast-track permit process. In this selection process, Costa Rica competed with many developing countries, in particular with Mexico and Brazil. Although all three countries met the criteria mentioned above, Costa Rica was selected because of two important elements: negotiating tactics and specific concessions. Intel is now Costa Rica's major exporter, generating more than 2,000 jobs, and using around 300 local suppliers.

Finally, Ms. Gonzalez explained the key factors used by Costa Rica to attract investment:

- Investment promotion is made along with the participation of strategic partners e.g. MNEs, universities.
- Key drivers include political and social stability, economic openness and liberalisation, receptive investment environment, people, improved infrastructure, strategic location and a proactive attitude.

Following Intel's lead, many other multinationals have set up business in Costa Rica, including Procter and Gamble, Abbott Laboratories, Western Union, Sykes, McGhan Medical, Narda, and Teradyne.

Mr. Jacques Morisset, the World Bank's Lead Economist and Programme Manager for Africa, made the presentation *Foreign Direct Investment in Africa: Policies also Matter*. He stressed that the capacity of African countries to attract foreign direct investment (FDI) is mainly determined by their natural resources and the size of their local markets. In his presentation, Mr. Morisset showed this argument is supported by the apparent lack of interest of transnational corporations (TNCs) in African countries that have attempted to implement policy reforms.

Mr. Morisset said that it has been argued that reforms in many African countries have been incomplete, and thus have not fully convinced foreign investors to develop activities that are not dependent on natural resources and aimed at regional and global markets. His presentation was aimed at identifying African countries that have been able to attract FDI by improving their business climate, adopting proactive policies and reform-oriented governments. He concluded that over the past decade, several African countries have attempted to improve their business climate in an effort to attract foreign companies. To improve the climate for FDI, an econometric analysis indicated that strong economic growth and aggressive trade liberalisation can be used to fuel the interest of foreign investors.

Beyond macroeconomic and political stability, African countries that have been successful in attracting FDI focused on a few strategic actions such as:

- Opening the economy through trade liberalisation reform
- Launching an attractive privatisation programme
- Modernising mining and investment codes
- Adopting international agreements related to FDI
- Developing a few priority projects that have a multiplier effects on other investment projects
- Mounting an image-building effort with the participation of high political figures, including the President.

Panel B – Government Responsibility: Beyond Traditional FDI Policies.

Mr. Wesley Scholz, Director of Investment Affairs at the United States Department of State, chaired the Panel B Session. In launching the discussion, Mr. Scholz said that the new trends and developments need to go beyond traditional Foreign Direct Investment Policies and take a broader perspective as to the interaction of related policy tools. The Rapporteur in Panel B was **Mr. Rogelio Arellano Cadena** from the Mexican Delegation to the OECD.

Mr. Vudayagi N. Balasubramanyam, Professor of Development Economics at Lancaster University, England, made a presentation on the *Need for a broader policy approach to FDI and effective implementation*. In his presentation, Mr. Balasubramanyam addressed two interrelated issues of concern to developing countries: the factors that determine FDI flows and the preconditions for the efficient utilisation of FDI in the development process.

He discussed the main determinants of FDI: size of markets, infrastructure, macroeconomic stability, product and labour market distortions, incentive schemes, integration schemes, methods of foreign enterprise participation, attitudes, and business environment. He also analysed the necessary preconditions for the efficient utilisation of FDI in the development process. Mr. Balasubramanyam identified four propositions related to the efficacy of FDI:

- FDI is not a panacea for the development problem; it is a catalyst of growth and development.

- The type of trade policy regime in place influences the allocative efficiency of FDI.
- Competition in the market place is an essential precondition for the effective utilisation of FDI.
- Incentive packages and various sorts of regulations imposed on foreign firms may not always be conducive to their efficient operation.

The second presentation *Home country perspectives*, was made by **Ambassador Marino Baldi**, State Secretariat for Economic Affairs, Switzerland. Mr. Baldi said that traditional policies and measures for attracting or promoting inward investment could, at the utmost, play a complementary role. They do not by themselves attract FDI. It should always be borne in mind that investors make their investment decisions on the basis of economic considerations. In other words, FDI goes to countries where investors can expect a reasonable return on capital, and such returns depend primarily on market opportunities, along with sound economic policies and a transparent and predictable legal framework. Instead of concentrating on measures that are at the most, second-best options, host and home countries should focus their efforts and activities on shaping a pro-business environment in recipient economies and on improving the long-term functioning of markets.

The third presentation, *Making FDI and financial-sector policies mutually supportive* was made by **Mr. Pierre Poret**, Head of Division of the OECD Directorate of Financial, Fiscal and Enterprise Affairs. Mr. Poret argued that the development of a sound and efficient banking and financial sector is widely recognised as an important ingredient of an effective system of resources allocation and robust growth within national economies. It has also proven to be a key condition for ensuring orderly capital account liberalisation.

A solid domestic infrastructure for banking services and capital markets are among the parameters considered by investors when they decide on the location of their investments. An important trend in world FDI flows in recent years has been the strong orientation of FDI towards the services sector. More than half of OECD countries' FDI involves the service sector. Banks and other financial institutions accounted for a very high share of these investments. But only a small part of OECD countries FDI outflows is directed to developing countries – largely concentrated in a few countries in Latin America and Asia. This suggests that there is significant under-exploited potential for many other countries around the world to catch up.

Russian Experience Regarding the Impact of Competition Policy on FDI Flows was the subject of the presentation made by **Dr. Nataliya Yacheistova**, Advisor to the Minister for Anti-monopoly Policy & Support of Entrepreneurship, Russia. Ms. Yacheistova talked about the general view of FDI in Russia. She pointed out that until recently the volume of FDI in Russia had been moderate. FDI into fixed capital dramatically declined during the last decade. But at the beginning of 2000, positive tendencies emerged. In 2000, FDI inflows increased to U.S.\$4.26 billion. In the first half of 2001, FDI inflows to Russia increased by 40 per cent as compared with the first half of the previous year. The three leading foreign investors in the Russian economy are Germany, the United States and Cyprus. It is important to note that the biggest investment projects are concentrated in the oil and gas sectors.

Ms. Yacheistova recognised that the most important remaining problems faced by foreign investors in Russia are the following:

- Complicated tax system
- Infringement of investor rights in bankruptcy procedures

- Infringement of intellectual property rights
- Contradictory and insufficiently transparent legislation
- Weak court system
- Corruption
- Weak banking system
- High administrative barriers
- Inadequate accounting system.

The Russian anti-monopoly authorities are now playing an important role in supporting general governmental policies directed at creating an attractive investment climate in Russia.

In her presentation, *Foreign Investment in South Africa*, **Ms. Maliza Nonkqubela** showed that South Africa's economy is at present the largest in Sub-Saharan Africa. It is around four times larger than those of the rest of Southern Africa. Since South Africa's transition to democracy in 1994, the economy has undergone major transformations, including:

- Signing up with the WTO and the consequent extensive phasing down of import tariffs.
- Commitment to a sound macroeconomic policy in the form of growth, employment and redistribution frameworks, which has resulted in the stabilisation of key macroeconomic variables, such as inflation, budget deficit, and interest rates.
- The completion of Free Trade Agreements (FTA) with the European Union and the Southern African Development Community (SADC), qualification for preferential tariff access in terms of the unilateral U.S. Africa Growth and Opportunity Act (AGOA) as well as ongoing negotiations with respect to an FTA with MERCOSUR.

These policy measures have led to steady economic growth, strong export growth and the attraction of FDI from a wide range of countries. The policy message that Trade and Investment South Africa (TISA) wishes to see from the OECD conference is that there should be a more informed evaluation of emerging market economies in general, and promising African economies in particular. Undue Afro-pessimism should not lead to irrational investment decisions. TISA feels that South Africa has not attracted as much FDI as its economic fundamentals justify.

In his presentation, *Trade Policy and FDI Linkages*, **Mr. Michael Gestrin**, Administrator of the OECD Trade Directorate showed that economies that are open to trade and investment have grown faster than closed economies. FDI is one, but not the only, mechanism to increase economic growth. If policy-makers focus on just trying to attract FDI to an economy with an environment that is unfavourable to domestic investment and private enterprise, the results are likely to be less favourable with respect to the long-term development of the economy. The enabling framework for FDI consists of rules and regulations governing entry and operation of FDI. Although open FDI policies are a necessary condition, a wide range of other policies and linkages affect FDI decisions. These include government measures that influence institutional effectiveness, infrastructure and skill endowments, and macroeconomic and political stability. They also involve policies towards private enterprises in

general: tax, labour market, environment, public administration, financial sector, foreign trade and exchange rate policies.

The final presentation of Panel B, *FDI and Environment*, was made by **Ms. Aimée T. Gonzales**, Senior Policy Adviser, WWF International. Ms. Gonzales showed that FDI policies need to pay more attention to the broad set of regulatory and institutional frameworks conducive to an enabling environment for FDI. These include the protection of labour rights and the environment. She also recognised that FDI produces benefits, but it also produces environmental problems. Ms. Gonzales made a reference to the mining industry and its environmental impact. Although the mining industry is dwarfed by other industry sectors – annual raw metal production is estimated at US\$93 billion – mineral exploration and extraction can have a strong impact on the natural environment and neighbouring people. Several investigations showed that mining affects the environment and associated biota through the removal of vegetation and topsoil, the displacement of fauna, the release of pollutants into the air and water, and the production of mine overburden.

The way private enterprises are governed and behave, both domestically and internationally, is important for economic development. In recent years, there have been an increasing number of corporate voluntary initiatives regarding environmental and social issues. Corporate codes of conduct cover broad range of issues, such as environmental management, human rights, labour standards, nature, consumer protection, competition, science and technology. A lot still remains to be done in environmental matters.

Panel C – Capacity Building for FDI in Host Countries.

Panel C was chaired by **Mr. Carlos García Fernández**, Director General for Foreign Investment of the Ministry of Economy, and the Rapporteur was **Mr. William Nicol**, Head of Division of the OECD Development Co-operation Directorate.

Mr. Richard Newfarmer, of the World Bank's Economic Advisor Policy and Prospects Group, made the first presentation of this Panel on *Improving the Investment Climate: New Policies and Institutions*. In his presentation, Mr. Newfarmer focused on the importance of the theory that suggests that raising the Total Factor Productivity (TFP) is more important than capital accumulation, and FDI contributes positively to growth, especially by raising TFP. Mr. Newfarmer demonstrated that with the establishment of stable macroeconomic policies, removing policy-induced barriers to entry and competition, creating a positive investment climate, eliminating corruption, and investing in education, countries can obtain the most TFP from FDI. He placed special emphasis on creating infrastructure and using proactive policies. He stressed the importance of FDI entry seeking, linkage creation, and technology networks.

In the second presentation, *International investment agreements and instruments*, **Mr. Carlos García-Fernández**, Director General for Foreign Investment of the Ministry of Economy, explained the recent trends of FDI and stressed how during 2000, FDI world flows maintained their increasing trend, registering in that year a total amount of US\$1,270 billion (growth of 18 per cent compared to 1999). Mr. García pointed out that in the context of economic globalisation, mergers and acquisitions (M&As) were the most important vehicle for the expansion of FDI flows. Three factors have been crucial to this expansion: 1) liberalisation of investment regimes, 2) technological process, and 3) corporate strategies.

However, Mr. García raised the following questions: Are we on the right path? What can we learn from the experiences of countries involved in FDI liberalisation? Where should we move? What

lessons can be learned from the MAI? Are governments working properly in the interest of both investors and society? Mr. García then outlined the most important investment instruments worldwide, such as the Bilateral Investment Treaties (BITs) and the relevant investment instruments in international agreements and organisations such as the OECD, APEC, Andean Community, CARICOM, MERCOSUR, and the FTAA. Furthermore, Mr. García emphasised that at the WTO, ministers recognised the case for a multilateral framework to secure transparent, stable and predictable conditions for long-term cross-border investment.

Finally, Mr García stressed that, at this point in the time, there is a patchwork of Regional and Bilateral Instruments on Investment that regulate FDI flows. It is difficult, however, to predict the outcome of the WTO, and it is necessary to agree international standards on investment as has been done in trade. This would create legal certainty and stability.

In his presentation, *The benefits of FDI in a Transitional Economy: The case of China*, **Mr. Yasheng Huang**, Associate Professor at Harvard Business School, explained the importance and benefits of China's accession to the WTO. He mentioned that the most important benefit of WTO membership is that it will attenuate the inefficiencies of domestic financial and economic institutions. WTO accession is likely to promote internal reforms in three ways: 1) Chinese leaders today are facing a stark choice between socialism and nationalism, but China has created many profitable business opportunities for foreign firms; 2) a likely effect of WTO membership will be improved efficiency in China's service sector. As regards reforms in the banking, insurance, wholesaling, retailing and telecommunications sectors, WTO accession will force China to open its doors to the most efficient foreign service providers; 3) Finally, the third likely effect of WTO membership is that China will become more institutionally integrated into the global economy. So far, the open-door policy has increased China's economic integration. Examples of this are the increasingly large share of GDP that is traded on the world market, and the large portion of the capital formation that comes from foreign sources.

Ms. Patricia Francis, President of Jamaica's Promotions Corporation and President of the World Federation of Investment Promotion Agencies, spoke about *FDI Linkages with Local Enterprise Development*. In her presentation, Ms. Francis explained that since many developing countries have begun to search for ways to increase the benefits from FDI, one of the ways is through increased backward linkages between foreign controlled companies and local firms. In the process of promoting linkages, many countries have recognised that protectionist policies and local content programmes, previously used to force foreign companies to buy local inputs, do not work well in the changing international environment.

Studies on the Jamaican economy showed that whereas FDI can greatly assist in technology-sharing among other things, the real adaptation of these technologies is done in large part by local firms who then localise these technologies to improve their efficiency – a process known as “innovation”. It is when partnerships are formed between the suppliers of capital (TNCs) and those best able to localise its use (Jamaican Firms) that capital's marginal productivity increases and stimulates company development, which places the economy on the optimum growth path. These partnerships also reduce the net cost of capital to both TNCs and Jamaican firms.

In presenting *FDI, Official Development Assistance and Capacity Building: Prospects and Policy Challenges*, **Mr. William Nicol**, Head of Division, OECD Development Co-operation Directorate, stressed that international investment rules at bilateral, regional, and multilateral levels can play a key role for the purpose of improving the legal environment for FDI worldwide as a complement to domestic reforms. However, investment rules alone are not enough to ensure that all countries attract a greater proportion of the increasing flows of FDI. The main determinants of international investment

flows in a given country are market size and structure, macroeconomic and political stability, level of infrastructure, labour skills, etc.

An improved legal framework should be developed together with measures aimed at creating a supportive business framework that would maximise the potential that countries have for attracting FDI. This enabling environment for FDI should include good governance, effective justice systems, respect for the rule of law, etc. Not only does it make a country more attractive to FDI inflows, but it also helps it to absorb the flows in a more productive way. In this context Mr. Nicol explained that it is crucial to identify what appropriate assistance could be envisaged to ensure that developing countries exploit their full potential by attracting more capital flows and consequently increase their economic growth.

As a first step, developing countries could receive assistance on two fronts: on the one hand, assistance should aim at identifying the key requirements for increasing their attractiveness as investment locations and the key bottlenecks that frustrate domestic policies to this end. On this basis, assistance could then be directed at building capacity to: 1) regulate domestic markets in order to attract investment; 2) identify and deal with obstacles to ordinary market functioning, e.g., competition policy. On the other hand, developing countries should receive assistance to negotiate international investment rules effectively, and to transpose the results of negotiations into domestic laws and regulations.

Finally, in his presentation, *Corruption is a Barrier to FDI*, **Mr. Luis Bates**, from Transparency International, explained that one of the main problems is the abuse of government's position. He also addressed the problem of public and private corruption, even in the case of transnational bribery. An example of the consequences of such practices is the difficulty of applying rules that could be significantly reduced through government modernisation and the legitimisation of institutions and all public workers. He stressed that the current position of Latin America is weakened by extreme corruption, mainly due to political, ethical, and economic factors.

Panel D - Initiatives for Corporate Responsibility and Economic Development

Mr. Steve Canner, Vice-President, U.S. Council for International Business chaired the Session. In launching the discussion, Mr. Canner pointed out that OECD Guidelines for Multinational Enterprises contribute to the responsible conduct of companies. The Chair also stressed that, with a few rare exceptions, commerce and investment are the main causes of environmental problems. The OECD recognises that FDI could have both good and bad effects. That was certainly one of the reasons the GFII was set up: to discuss how business and enterprises could contribute to sustainable development.

In his presentation on *Trade Union Perspective*, **Mr. Jim Baker**, Head of the Multinationals Branch, International Confederation of Free Trade Unions, explained the implications of corporate social responsibility in economic development. Economic development is based on the notion that development should be both economic and social, and in this way, will produce the most for nations and communities. Corporate social responsibility should therefore be carried out in a way that encourages that kind of development. It could, however, discourage or be irrelevant to it, because there are many different ideas and examples of how economic development really takes place. The main problem is the respect of minimum labour standards, and that corporate social responsibility must be considered in the context of the competitive pressure to violate workers' rights.

Corporate social responsibility cannot, however, be expected to replace the responsibility of governments, because it cannot completely fill the void created by governments that are incapable of protecting the rights of their citizens. The impact of corporate social responsibility will not be felt in countries where governments effectively protect labour standards. Mr. Baker also stressed the

importance of encouraging good industrial relations policies, allowing workers the opportunity to have global collective bargaining agreements, or providing the space for workers to organise trade unions without fear. The OECD Guidelines for Multinational Enterprises and the unilateral codes of conduct, offer a great opportunity for governments to be relevant to the social needs of the global economy, contribute to real social and economic development, and guarantee the rights of workers.

In the second presentation, *Corporate responsibility and Competitiveness*, **Mr. Enrico Massimo Carle**, Chairman on Investment and Multinational Enterprises, BIAC, stated that corporate social responsibility has to do with voluntary measures that a company takes to develop good management systems. These, in turn, enhance a company's ability to sustain their franchise and build a record of sustained growth, by engaging positively with the societies in which they operate. Thus, the decision by a company to adopt a certain code of conduct will depend on the objectives of the individual company and the relative value added each code can offer. However, Mr. Carle stressed that the behaviour of an enterprise is the most important indicator of its commitment to good business practices. He also explained that an increasing number of companies are communicating to the public their good management systems (implementation of practices and policies related to environmental, health, safety and employee benefits), in contributing to economic development.

Mr. Carle pointed out that the OECD Guidelines for Multinational Enterprises serve as an important benchmarking tool for companies as they develop their internal management systems, and that this is the main reason for BIAC and its member organisations to continue the promotion of the OECD Guidelines. The Guidelines are a voluntary tool to improve the climate for foreign direct investment and sustainable growth, and to encourage a balance of responsibility between international business and governments. Nevertheless, there are limits on what should be expected from company performance. Companies cannot substitute for governments in building the policy mosaic, that is, the co-ordinated legal framework and basic infrastructure, needed to establish fully the conditions for economic growth. Good public governance, an adequate education system, and training in basic skills are essential to attract FDI and trade.

In closing, Mr. Carle concluded that it is very important that policy-makers keep in mind that the benefits of all the instruments and codes should be the implementation of effective management systems within companies. Governments and business alike need to be sure that policy decisions in these areas enhance, and do not inhibit, the benefits of trade and investment.

In the third presentation *Corporate Social Responsibility: Are the investors the solution or the problem?*, **Mr. Raj Thamotheram**, Senior Adviser, Socially Responsible and Sustainable Investment, Universities Superannuation Scheme Ltd., began by asking "Are investors the ones who are interested in corporate governance and corporate social responsibility part of the problem or part of the solution when they come to invest in emerging markets?" His answer covered the following four points:

- How different investors have very different agendas. Governments who wish to mobilise resources need to understand that different investors respond to different drivers, and then choose who they want to work with most.
- How – by responding to the developing interest in corporate governance and corporate social responsibility by investors – you can encourage those major investors who are wary of emerging markets.
- Who needs to do what, focusing on what OECD and non-OECD governments can do.
- And finally, why institutional investors are not the cure.

For the first point, the speaker explained that there is a range of investors, each with differing interests, for example insurance companies, which generally hold stock for longer than active managers, and shorter than pension funds, or pension funds which typically might hold stock for several years. These kinds of investors have very different interests, so who should governments and inter-governmental bodies like the OECD, listen to most carefully? Pension funds and other institutional investors should get this recognition because pension funds are the most patient sources of capital, and the beneficiaries of funded pension funds make up a significant percentage of society, especially in some OECD countries.

For the second point, Mr. Thamotheram considered, in general terms, that if governments help ensure that companies meet benchmark standards on corporate governance and corporate social responsibility, this will encourage a more positive approach from potential investing institutions.

For his third point, he stressed that OECD governments need to send clearer signals to the public that they want investors to be responsible and active long-term owners. He also considered that governments can be supportive of companies that adopt good practice standards in corporate governance and corporate social responsibility. This is as important for OECD governments as it is for non-OECD governments, as illustrated by the positive experience of the UK Government in this regard.

In answer to his last question, the panelist explained that governments couldn't expect institutional investors do their work. Both OECD and non-OECD governments need to encourage companies to adopt benchmark standards of good practice on corporate governance and corporate social responsibility issues, and encourage investors to be responsible and active shareholders.

In his presentation, *Do Corporate Responsibility and Private Initiatives Work for Development: An OECD Perspective*, **Mr. Pierre Poret**, OECD Head of Division, pointed out that responsible business conduct by multinational enterprises (MNE) can help countries reap the full benefits of international direct investment for development. Private initiatives for corporate responsibility are efforts by companies to develop and maintain internal control systems that allow them to comply with market, regulatory and other legitimate expectations. Mr. Poret mentioned the importance of the recent OECD Study, *Corporate Responsibility—Private Initiatives and Public Goals*, which includes initiatives for codes of corporate conduct setting forth commitments in such areas as labour relations, environmental management, human rights, consumer protection, competition, disclosure and fighting corruption. The countries adhering to the OECD Guidelines want to use them as a framework to reinforce private initiatives for corporate responsibility.

Mr. Poret explained, with some illustrations, that the approach of the Guidelines is not one of regulation, but rather one that favours co-operation and the accumulation of expertise in order to enhance further the benefits of international investment. Private initiatives for corporate responsibility raise significant challenges from a developing country perspective, and can occasionally have “unintended consequences”, and he underscored the need to proceed carefully with corporate responsibility initiatives and to have adequate knowledge of local conditions. The code emerged as a result of what is now an infamous case of unintended consequences of NGO activity, in this case, in response to the revelation that children were involved in the production of soccer balls in Pakistan. As a result of NGO activity, soccer ball suppliers in Pakistan were instructed to stop employing children immediately, which they did. However, since many of the children had been brought in from surrounding areas to work in factory-type situations, they ended up on the streets without caretakers or family supervision.

The notion of corporate social responsibility is not meant to be a substitute for the responsibility of other stakeholders, particularly states themselves. Governments have the responsibility of ensuring a favourable environment for business, through provision of such services as law enforcement, appropriate regulation, and investment in the many public goods and services used by business. And businesses, beyond their core objective of yielding adequate returns to owners of capital, are expected not only to obey the various laws applicable to them, but also to respond to the societal expectations that are not written down as formal law.

During the debate on corporate social responsibility, fiduciary was identified as being the main goal of enterprises. On the concept of “corporate social responsibility” itself, one panelist made reference to a study that says that such a concept was brought by “non-democratic NGOs”. In response to this, another panelist stressed that corporate social responsibility is in the interest of investors themselves and, in particular, that the OECD Guidelines are a co-operative approach to governance and regulation. There was also some debate on the timeliness of introducing the OECD Guidelines into the WTO; although arguments diverged, participants did not seem to consider this an appropriate idea.

In his presentation, *Codes of Conduct in Support of Development?*, **Mr. Herbert Oberhänsli**, International Chamber of Commerce (and Manager, Economic and International Relations, Nestlé, SA) recognised that corporate social responsibility (CSR) is not a recent creation, but has always been inherent to enterprises’ competitiveness and long-term success. He also pointed out that, in order to improve their contribution to development, companies need to be focused, to think and act on a long-term basis, and to use dialogue rather than guidelines. In talking about the experience of the company he represents, he stated that low wages are not a factor in attracting investment, and explained how his company, which is present in many developing countries, has operated on the basis of trust and on dialogue with suppliers (farmers), workers, employees, trade unions, customers and governments, with a view to finding common interests.

An NGO perspective on the benefits and costs of FDI and on the role of codes of corporate conduct was provided by **Mr. Brett Parris**, of World Vision, Australia, in *FDI and Corporate Codes of Conduct in National Development Strategies: Costs, Benefits and Policy Options*. He affirmed that FDI should be evaluated in an economic and social cost-benefit framework, taking into account appropriate shadow prices, discount rates and distributional weights. The context of the evaluation should be the country’s own development strategy, including goals such as social development, poverty reduction and industrial restructuring. Moreover, he elaborated on the benefits and costs of FDI by multinational enterprises in developing countries, with a focus on evidence about costs in areas such as: FDI and technological spillovers; FDI and trade policy; FDI, Transfer Pricing and Tax Avoidance.

On the ability of codes of corporate conduct to modify corporate behaviour, the panelist identified three important factors: what is included in the codes, what is left out, and, most importantly, how they are promoted, monitored and enforced. On the role of codes of conduct, Mr. Parris said that they can go so far towards ensuring social benefits from FDI, but there is a need for a sound institutional environment with democracy, with competent, honest bureaucracy and judiciary, and laws to protect the environment and workers' rights. He stressed that codes of conduct can help better performance but they cannot replace a legal and political framework.

In the *Role of multinational enterprises in economic and social development of energy-rich transition countries*, **Mr. Fikret Pashayev**, Deputy Head of Department, Ministry of Foreign Affairs, Azerbaijan, focused on the role of FDI in newly-independent energy-rich transition countries in the Caspian Sea region, and in particular on the Azerbaijani experience in the last decade. He explained some of the reforms undertaken by his country, with a particular emphasis on liberalisation, private sector

development, and transformation into a market-oriented system. Furthermore, the panelist explained some of the reasons why Azerbaijan has been able to attract important levels of FDI (rich oil and gas reserves in the Caspian Sea basin; good investment opportunities; skilled labour force at competitive costs; long-term market potential; global competition in oil industry). In closing, Mr. Pashayev referred to the contribution of multinational enterprises to the development of his country.

There was a discussion about the growing number of initiatives on corporate social responsibility. It was said that all initiatives have something to offer, and that the OECD Guidelines have a particular role to play, as they cover an extensive range of topics. One panelist stressed the need to focus on dialogue more than on initiatives, while another pointed out the importance of focusing more on the behaviour of the company and on the improvement of the situation, rather than on which code has been adopted. There was disagreement among panelists on the issue of cost-benefit analysis of proposed FDI that had been introduced by one of the panelists.

REPORTS BY PANEL CHAIRS

Panel A - Benefits of FDI for Development: Country Experiences, *Mr. Neil Roger*

The discussion confirmed that the desirability of foreign direct investment as such is no longer an issue. All countries covet FDI. It was noted that, at Doha, 140 countries had, for the first time, agreed on the need for a multilateral framework to foster FDI. If there are concerns on FDI, these tend to relate to attendant issues. Particular mention was made of its impact on the economic development of a country and the position of workers: how could benefits be maximised and advantages more widely shared? For many countries, however, the primary concern is to attract FDI in the first place; maximising its benefits is almost a luxury question to them.

Even if we do want FDI, it seems that, as a world community, we are still not good at obtaining enough of it. Countries tend to see one another as competitors for a limited pool of investable resources. On the other hand, it was noted that there are abundant resources, which could be invested, but are not, because attractive projects are lacking. This suggests that the fear of competitors among investment promotion agencies is a bit of a red herring and that, if a country is attractive enough, and tells the world so, investors will come.

But how can a country be made attractive as a venue for FDI? Potential investors tend to compare risks with potential rewards, and to invest where the trade-off is the most favourable. Throughout our discussion, many “reward-generating” factors were cited. To mention only the most important:

- The proximity of a large market, facilitating just-in-time deliveries;
- The presence of a young and well-educated labour force;
- Lack of cumbersome administrative procedures, which convey hostility to investors;
- A trustworthy rule of law;
- Free-trade agreements with major markets, giving the country a gateway position for investors to these markets;
- A good infrastructure;
- Macroeconomic and political stability;
- Trail-blazing by a major investor (e.g. Intel’s investment in Costa Rica was followed by dozens of other IT companies).

Two country cases (Mexico and Turkey), were presented, both of which, superficially, seemed similarly attractive to FDI: their potential as a gateway to a major market (the U.S. and the EU), bolstered by free-trade agreements, good infrastructures, and young well-educated workers. Yet Mexico has proven a far greater success as an FDI venue than Turkey. This shows that even if a country does many things right, this will not be enough if other factors are neglected. Unlike Mexico, Turkey does not enjoy macroeconomic stability. A recent study has concluded that its administrative

barriers cost the economy more than it presently receives in FDI. And Turkey is unlucky enough to be situated near a politically unstable region, the Balkans. Indeed, policies matter, as a speaker expressed it. The cases of Mali and Mozambique were mentioned, both of which have attracted more FDI than many other, larger African countries. Why? Because Mali and Mozambique pursued the right policies: an attractive privatisation programme, a modern and working mining law, accession to international agreements, an open economy.

Countries should be alert to the ephemeral nature of some advantages. For example, Mexico will lose its preferential access to the U.S. under NAFTA once the FTAA is in place.

Last, but not least, if a country is to attract investors, and especially the “big fish” (we were told of Costa Rica's successful wooing of Intel), it needs a strong and visible commitment from its top officials. The smaller countries, especially, have to ensure that they are seen and heard. Advice was given on the way to use news media contacts for this purpose. It is essential to build long-term relationships with the media. Indeed, the big reward, in the form of a major investor like Intel, may be years in the making.

How can a country ensure that the potential benefits of FDI to its economic development are realised? The optimistic view is that FDI has a proven record as a generator of economic growth, jobs and regional development, Mexico being a case in point. While this view was not contested, three kinds of qualifying observations were made.

The first was that foreign-invested sectors tend to stand out as export-oriented “islands” that are not sufficiently interwoven into the larger economy: “backward linkages” to the domestic sector are insufficiently developed, and as a result the economy benefits below its potential.

The second qualification concerned the impact of FDI on the host country's workers. The surge of FDI into Mexico has not stopped real wages in this country from declining. In some countries, like Malaysia, foreign-invested enterprises have employed immigrant workers on a large scale, and these are the first to suffer when business turns bad, as demonstrated during the 1997/1998 Asian crisis. Many countries have no social safety nets. Some restrict workers' rights of association in order to attract investment. Malaysia was again mentioned as an example, but China deserves a special mention here, as this country is not “handicapped” by free trade unions or a vocal and critical civil society. Fears were expressed that China's emergence as a competitor for FDI may tempt other countries in the region to restrict trade union activity.

The final qualification related to the quality of legislation. It is one thing to have all the right laws on your law books, but quite another to ensure that these laws are implemented and that they are understood by those who implement them. An enormous effort in capacity building in this area will be required. The “Doha Development Agenda” will do just that. This must also be a key issue on the Finance for Development Agenda. This Agenda should include a study of how official development assistance (ODA), which tends to flow to those countries that receive little FDI, can be used to build this kind of institutional capacity.

Panel B – Governments' Responsibility: Beyond Traditional FDI Policies, *Mr. Wesley Scholz*

Recognising that FDI flows are a key variable to face the global economic downturn, panelists in this session discussed both traditional and so-called new policies to attract and promote FDI. The main ideas that emerged from the discussions are:

- Sound macro policies and a market-oriented approach, including competition, regulatory reform, safeguard of intellectual property rights and the rule of law to build up trust, are fundamental to facilitate FDI flows;
- In addition, government, enterprises, and society as a whole can favour FDI flows and their positive impact on the economy through public and corporate governance;
- The need for a multilateral framework on investment was another of the issues discussed. Though views differed as to the WTO being the Organisation to handle investment rules, there was consensus that such rules needed to be balanced, taking into account developing country needs. Here, the role of capacity building and support for infrastructure development in LDCs was also pointed out;
- In this regard, the codes of capital movement and the Declaration of International Investment have been important steps that OECD countries have undertaken to liberalise investment flows;
- During the session it was also stressed that investment incentives are inefficient, creating distortions and even discriminating against domestic firms. However, there were no consensus on an international agreement, or domestic instruments, to regulate such incentives;
- Finally, taking into account society expectations, including the protection of the environment and basic labour rights (as is done in the Guidelines for Multinational Enterprises), would also facilitate the maximisation of FDI benefits.

Panel C - Capacity Building for FDI in Host Countries, Mr. Carlos Garcia Fernandez

One of the major routes by which FDI benefits development is the transfer of technology.

- Technology is a major determinant of growth.
- What capacities are needed to ensure that the transfer of technology actually takes place?
- We need to look at the transfer of technology from parent to subsidiary companies, from demonstration effects, from labour turnover, from vertical linkages. But we also need to know more about these mechanisms.

How can technology and productivity benefits be maximised?

- A stable macroeconomic climate.
- Remove policy barriers (e.g. tariffs) that devalue the benefits of FDI.
- Strengthen the investment climate (property rights, protection of intellectual, etc).
- Invest in education.
- Proactive policies – entry seeking (e.g. through strengthening competition), linkage creation, technical networks. But we need to learn how to replicate good country experiences.

Institutions are important – as the analysis of FDI in China shows

- Fragmentation of markets (product, financial) reduce “economic mass” and attractiveness to FDI – so policies to promote integration are very important.

- Full benefits from FDI require equal actions at the domestic level – there are important complementarities between the foreign and domestic sectors that need to be exploited, and FDI provides a stimulus to move ahead on the domestic scene. Otherwise, biases will limit benefits.

Capacities to develop and use investment agreements are now a key part of the FDI architecture.

- Investment agreements (bilateral, international) are important for the rules of the game and for strengthening business certainty – by focusing on legal protection, dispute settlement, liberalisation commitments.
- Bilateral investment agreements are important stepping-stones to broader international ones.
- Investment is already addressed in the WTO (via TRIMs, TRIPs, GATS), and “modalities” are to be addressed post Doha – so should WTO be the place to discuss an international framework for investment? If so, it will be important to bring in the development dimension from the outset.
- Doha has a major development and capacity agenda. But past lessons show how important it will be to raise and manage the financing needed for this capacity-building agenda.

Linkages with the domestic sector are critical to realising the full benefits of FDI.

- Earlier approaches to ensure such benefits (e.g. tariffs, local content requirements, joint ventures, etc) were not successful.
- But we are now realising the importance of upgrading the local supply chains, modernising industry, and strengthening productivity to reduce costs and improve quality.

ODA and FDI are largely unconnected – can we pull them together to strengthen capacity building initiatives?

- Many lessons – for governments, for donors, for the private sector – are being learned from past experience.
- We need to take a more systemic, strategic and comprehensive approach, based on partnerships of all stakeholders, shared responsibility, and accountability.
- We also need to distil key messages from OECD, World Bank, etc. work on how FDI contributes to poverty reduction and set these out in political and strategic ways to mobilise funding for capacity building. We need to convince donors, and some governments, of this need.
- This is all the more important today in light of the major shortfalls that exist in mobilising financing for development (the subject of the March 2002 Conference in Monterrey on this theme) and in light of the major capacity building agenda resulting from Doha.

Corruption devalues the benefits of FDI – and major capacity building initiatives are needed at all levels – governments, institutions, enterprises and individuals

- From Klitgard, we know that corruption is a function of monopoly, opacity, and discretionary powers. We need to build institutions and capacities that tackle all of these.

- Weak institutions are a major problem at all levels of government – national and municipal – and in the judiciary as well as in “line” Ministries.
- We need to look at strengthening transparency and reducing discretionary powers in both public and private sectors – by strengthening the role of market forces and codes and standards for both financial and corporate government, and by implementing ethics and integrity codes in the public and private sectors.

Panel D - Initiatives for Corporate Responsibility and Economic Development, *Mr. Steve Canner*

The Global Context: Benefits and Costs of FDI

- FDI can be of major benefit to developing countries (through technology spillovers, positive influence on labour conditions, capacity building, etc.)
- OECD and World Bank analyses tend to show that trade and investment are not a race to the bottom, and seldom the root causes of poverty, and that countries open to trade and investment grow faster (which, in turn, ensures more resources for governments to provide public goods and services)
- One panelist felt it was important to undertake proper cost-benefit analyses of proposed investments and their impact
- Whether FDI is beneficial does not just depend on the characteristics of a particular investment or company, but on local economic circumstances and government policies (“Policies Matter”).

What Do Enterprises Seek?

- Enterprises are engaged in trading and investing, and, to do this, seek out market environments with a stable business environment including rule of law, protection of intellectual property rights, enabling infrastructure – in essence good public governance.
- Fiduciarity is the first goal of enterprises.
- Corporate social responsibility is not a recent invention, but has always been inherent to enterprises’ competitiveness and long-term success.

How Efficient are Corporate Responsibility Initiatives?

- Usefulness of codes depends on what they cover, what they omit, and how they are implemented and monitored.
- CSR initiatives can have unintended consequences: problems can arise from well-meaning initiatives (such as what happened in the case of the production of soccer balls in Pakistan). This underscores that there can be no one-size-fits-all approach.
- Hence, all codes and initiatives (UN Global Compact, Sullivan Principles, etc.) have something to offer.
- The OECD Guidelines have a particular role to play because they cover a comprehensive range of topics (labour, environment, human rights, corruption, tax, etc.), but also because of their implementation by governments through national contact points.

- But, ultimately, what counts is not whether or not a company has adopted a code, but how the company internalises the code to impact company performance in the field of corporate social responsibility, beyond its legal obligations.

Where do the Responsibilities of the Different Actors Lie?

- CSR initiatives can be useful as an adjunct to a sound legal environment, provided by governments in host and home countries.
- Mutual dependence exists between enterprises and the societies in which they operate: a business sector cannot prosper in a failing society, and a failing business sector inevitably detracts from general well-being.
- CSR cannot be expected to replace government: private initiatives cannot be expected to work if public governance and other parts of the system work poorly.
- States have the responsibility of ensuring a favourable environment for business, through provision of such services as law enforcement, and investment in public goods and services.
- Because the OECD Guidelines for Multinational Enterprises are an expectation of governments, governments have an important role to play in their promotion. One panelist singled out raising the awareness of pension fund managers as an opportunity for promotion.

CHAIRMEN'S CONCLUSIONS

Co-chairs, Juan Antonio García Villa, Vice-Minister of Regulations and Foreign Trade Services, Luis de la Calle Pardo, Vice-Minister of International Trade Negotiations, and William Witherell, Director, OECD, summed up the deliberations of the Conference as follows:

FDI is needed more than ever....

There was consensus on the importance of sustained FDI flows in the current juncture of the world economic slowdown. FDI is a powerful engine for achieving the international community's reinvigorated development goals, particularly reducing poverty.

FDI should be strongly linked to local enterprise development and not be confined to small enclaves. An important challenge is to bring the less developed countries, particularly in parts of Africa and Asia, into the fold of countries that benefit from FDI inflows.

Policies matter...

It was agreed that with the current uncertainty surrounding short-term economic prospects and FDI, it is all the more necessary to get the conditions right for the forces that have driven the surge in FDI over the last decade to reassert themselves, and for reaping the full benefits of existing FDI.

The benefits of FDI do not accrue automatically, and are not uniform across sectors and countries. Policies and institutions matter. Experience shows that governments need to go beyond traditional liberal FDI policies. They need to pay more attention to the broad set of regulatory and institutional frameworks conducive to an enabling environment both for foreign investment and domestic entrepreneurship. These include the prevalence of rule of law, more transparent administrative practices, effectively combating corruption, good corporate governance, sound competition policy, as well as protection of labour rights and the environment.

Mexico is a case in point. Its reform efforts are paying off: FDI flows have been very robust, and they have been increasing in spite of the global economic slowdown.

Forging new partnerships for capacity building

Building necessary capacities is key to the coherence of policies and their effective implementation. It was agreed that there was a need to establish strong and new partnerships to contribute to the domestic capacity-building efforts in FDI host countries. These partnerships should include host and home countries, multinational enterprises, international organisations and civil society groups. They need to be turned into relevant and effective action. For its part, the OECD remains committed to making this Global Forum on International Investment and its other initiatives open to non-Members and other stakeholders for expertise sharing and broad-based dialogue.

Input to UN Financing for Development and other multilateral organisations

This publication of the results of the Forum are intended as an input into the preparatory process of the UN Conference on Financing for Development that will take place in Mexico in March 2002. They could also be fed into the investment work that is taking place in other multilateral organisations.