The attached proposal for future work under Investment Policy Analysis has been prepared by the Ad Hoc Task Group on Benefits and Economic Impact of Foreign Direct Investment, chaired by Elaine Drage, the UK Delegate.

It is submitted for consideration under item 5a of the agenda at the CIME meeting on 14-15 December 2000.

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CIME AD HOC GROUP “BENEFITS AND ECONOMIC IMPACT OF FDI”
MAXIMISING THE NET BENEFITS OF FDI FOR DEVELOPMENT

Introduction

1. Global outflows of foreign direct investment (FDI) have grown rapidly in recent years. In 1999 they reached $800 billion compared to $247 billion in 1993\(^1\). This growth far outstrips that in trade in goods. Governments have recognised the importance and potential benefits of FDI both to home and host economies. As a result many governments around the world, to varying degrees, are pursuing a policy of more open investment regimes in order to attract FDI and reap the benefits. The increasing number of bilateral investment treaties providing protection to foreign investments is another indicator of the importance of FDI to both host and home countries.

2. Despite the general agreement that FDI can bring positive net benefits to host countries, there are diverging views on how such benefits can be maximised (and how the costs can be minimised) in order to meet a country’s development needs. For example, some countries use screening procedures to select FDI projects which they consider best serve their country’s needs; some impose conditions on FDI in an attempt to ensure that technology is transferred; many do not permit FDI in certain sensitive sectors; while some are content to let market forces prevail to a large extent.

3. Counter to the impression of FDI as a positive influence has been the criticism of its perceived negative effects as witnessed in the wider debate on globalisation. The portrayal of multinationals disregarding national laws and wishes to extract maximum profit, promoted by some quarters during the wider debate on the Multilateral Agreement on Investment negotiations, has continued to be voiced. This, coupled with concerns about the distribution of benefits of FDI within host economies, has often overshadowed the positive benefits that FDI can and does bring.

What can CIME contribute?

4. One of the results of a failure to demonstrate to a wide audience the benefits that FDI can bring is that investment liberalisation may be rolled back by protectionist forces. One way of responding to this threat is to ensure that the benefits of liberalisation are properly understood and communicated. CIME has much it can offer to this work, for example by analysing the benefits and costs of liberalisation it can highlight those policies or policy frameworks that can best capture the benefits of FDI while mitigating the costs associated with liberalisation, and identify key issues that call for national or international action. Analytical work on the net benefits of FDI can also help to develop and maintain open policies towards international investment and explain the continuing relevance and benefits of these policies. Any work would utilise the analysis undertaken by CIME for the OECD-wide horizontal project on sustainable development which, among other things, is addressing the mechanisms through which investment impacts upon economic efficiency, environmental quality and social conditions.

\(^1\) UNCTAD World Investment Report, 2000
5. To foster the development of more liberalised investment policies among non-member countries and help build a fair and balanced framework for investment policies, non-member countries, and others, need to be aware of the benefits and costs associated with FDI. The arguments as to whether, to what extent, and in which ways international investment benefits development have become particularly topical in the past year. In order to adapt to the changing environment for international investment and respond to the issues under public debate, an analysis of the benefits and costs of FDI, therefore, has become a necessity. However, responding to this public debate and exploiting the comparative strengths of the CIME will require striking a balance between efforts to promote liberalisation and appropriate concerns for non-economic issues. A critical dimension of this work, therefore, would be an assessment of the international distributional gains from investment liberalisation and the reasons why some countries may be more able to take advantage of the gains from liberalisation.

6. The following project proposal outlines potential areas for examination with the objective of providing a balanced picture of the effects of FDI and highlighting successful policies and actions by host and home economies, and investors which help ensure that the positive effects are maximised and negative impacts minimised. It would focus on the economic impacts of FDI but also address relevant non-economic issues such as environmental and social impacts.
Project Specification

Objectives

- To identify the benefits and costs of FDI on home countries, investors and particularly on host countries.
- To explore, drawing on a wide range of existing studies, how the benefits can be maximised and the costs mitigated, particularly to assist countries in the process of development.
- Provide a sound analytical basis for dialogue with non-members on investment policy issues.

Questions

These questions are intended to act as a guide to assist the research.

- **What are the benefits and costs of FDI to host and home countries and investors?** There is a wide area where benefits and costs may be felt, including on economic growth, taxation revenue, wages and employment conditions, technology transfer, export growth, environment, competitiveness of the host economy, and management practices.

- **What can home and host governments, investors and companies do to maximise the net benefits of FDI?** Again there are many policies and actions which aim to maximise the net benefits of FDI including, performance requirements imposed by governments such as compulsory technology transfer, suppliers adapting their business methods to meet the demands of new FDI for example by adopting international certified management systems; government deregulation to allow all investment including FDI greater freedom to play a positive role in a host economy; linking up with local academic institutions; state aid; developing a suitable financial infrastructure; improving transport facilities and communications.

- **Why are some host government measures successful and others not? Are certain elements more appropriate for different stages of economic development?** There are areas where host government measures can make a positive difference and in examining the policies pursued by host governments the study should be able to shed further light on why some policies are successful and why some are not. This could include an examination of why policies pursued in one country or sector were more successful than near identical policies pursued in another. What conditions are necessary as a precursor to successful policies?

- **Can elements of a “best practice” list be compiled or are countries/investors so diverse that such an approach would have little relevance? If best practices can be identified, what are the obstacles to governments/businesses in adopting best practice or realising the benefits of FDI?** Clearly there are some elements that attract FDI or help to maximise its benefit that are beyond the control of governments and business such as geographical location; availability of natural resources; and language. However, it may be possible to identify policies (both government and business) which have been successful wherever they have been introduced, for example those that promote good governance or encourage dissemination of business best practice to SMEs. There may be a variety of reasons why countries or businesses have not introduced proven successful policies, including a lack of capacity or governance, reluctance to undertake reform.
through fear of causing unemployment, powerful vested interests groups resisting change, or lack of flexibility or resources from business headquarters in home economies.

- **Are there differences in perception of what maximises the benefits of FDI between investors and governments, and between developed and developing countries? Why?** There are a number of areas where host governments take measures aimed at maximising the benefits of FDI that investors regard as counterproductive. Some governments regard FDI as a contract between host government and investor and therefore negotiate with the potential investor to provide a “balance” of benefits for all. For example, a host government may have the attractions of a large, fairly affluent domestic market, good infrastructure and highly skilled labour and in return for permitting an investor to benefit from these assets would require that inputs are sourced locally or that a certain percentage of output is exported. Others believe that by giving an investor a freer reign greater benefits will occur as they make commercial sense for the investor.

- **What role is there for technical assistance to ensure that net benefits are maximised?** This could cover aspects such as technical assistance in promoting better regulatory and legal structures, good governance, infrastructure, an educated workforce, etc.

**Methodology**

In undertaking the project relevant studies in this area should be drawn upon (a preliminary selection is attached as annex A) and other resources and sources of information used. This could include the following:

- Contacting OECD Development Centre, UNCTAD and World Bank at outset of project and draw on their expertise on FDI and developing countries. Linking in to work already being undertaken in the OECD such as that on sustainable development.

- Drawing on studies of FDI covering representative countries at different stages of development from least-developed, through emerging and transition economies, to OECD member countries. By adopting this approach the study could show the policies that countries should be working towards in the long term and also, possibly, allow developed countries to benefit from best practice experience too. Countries selected will depend on the availability and quality of data/existing studies, however it is essential that they are from a representative sample. Possible countries include China, Russia, India, Brazil, Botswana, Uganda, Mauritius, Hungary, UK, France, Korea, Argentina, Poland, Egypt, Malaysia, Thailand, and Indonesia.

- Drawing on national experiences of OECD members and observers compile a questionnaire for OECD members/observers to contribute. This could cover OECD member/observer governments and business views.

- Obtaining developing country government views at an appropriate stage. Liaising with others including OECD Development Assistance Committee and OECD Development Centre, UNCTAD, and regional organisations involved in OECD outreach work.
**Output**

The output would provide a broad picture of the different areas studied, but primarily focus on good and bad experiences, and recommendations. It would not be a cataloguing exercise, but policy focused.

- List areas where FDI can have a positive and negative impact on host economies, home economies and companies (domestic and foreign investors) highlighting areas and specific examples where this is particularly evident with appropriate explanation.

- List measures that Governments and investors take which maximise FDI benefits and mitigate costs highlighting those that have been particularly successful or unsuccessful, or have been successful in one country but not in others, and examine possible explanations for this.

- List “barriers” to governments/businesses taking action to maximise the net benefits of FDI. Recommend any action which can be taken to address them.

- List technical assistance activities which aim to improve, or have the effect of improving, benefits of FDI. Highlight the more effective and least effective activities.

**Timetable**

Given the potential wide scope of the study a period of 9 months should allow the main issues to be presented to the CIME at its meeting in September 2001.

CIME could then consider any aspects which merit further discussion and/or analysis. This could take the form of a workshop or special session and could form part of the CIME outreach work to BIAC, TUAC and non-members.

This further work would aim at producing a report on the findings and policy recommendations. Such a report could be presented at the 2002 Ministerial and could form the basis for further dialogue with non-members.
ANNEX

OECD (1999) Trade, investment and development, reaping the full benefits of open markets, Paris: OECD


OECD draft Trade and Development Study(TD/TC(2000)14/REV1


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Hausmann, Ricardo and Fernández-Arias, Eduardo (2000) ‘Surges in foreign direct investment: good or bad news for Latin America?’ OECD Development Centre

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Ito, Takatoshi and Krueger, Anne (ed) (1999), ‘The role of foreign direct investment in East Asian economic development’ University of Chicago Press