OECD Publication Reviews the Role of Foreign Direct Investment in Development

Foreign direct investment (FDI) is one of the main features of globalisation and a key challenge facing both developed and developing countries is managing it as a force for global welfare. According to a new OECD publication, while FDI can entail drawbacks for host economies, the benefits that it brings generally outweigh the costs by a wide margin.

Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs surveys evidence from around the world of linkages between FDI and economic development in the countries that receive it. This publication aims to complement recent international policy statements, such as the Doha ministerial declaration and the Monterrey consensus, that have identified international investment and economic development as a priority area for further analysis and capacity building.

Investment generally improves a country’s economic performance. But foreign direct investment brings specific advantages. In countries with scarce domestic savings or inadequate credit intermediation, for example, FDI can act as a valuable supplementary source of finance. In most cases, FDI is also a less volatile source of external finance than loans and portfolio investment.

In addition, the OECD report concludes, foreign investors may bring important additional benefits for the host country’s business environment. These manifest themselves essentially through three channels:

- **Linkages between FDI and international trade.** The presence of foreign-owned enterprises helps to integrate developing economies more closely into international trade. A fuller access to trade is widely recognised to be one of the main sources of economic development.

- **Direct effects on the performance of the host country business sector.** The entry of foreign enterprises generally leads to productivity growth and enterprise development. This in turn can lead to enhanced competition -- particularly in previously shielded market segments.

- **Spillovers from foreign-owned to domestic enterprises.** The presence of foreign-owned enterprises may lead to important spillovers of technology, human capital and other competences to the domestic enterprise sector. However, this effect may depend on whether the business sector of the host economy has reached a certain "threshold level" of competences and host country authorities have a responsibility to ensure that this is so.
FDI also brings benefits in areas such as the environment and employment conditions. The OECD report cites evidence that foreign-owned enterprises in developing countries generally strive to perform above local standards. By being able to transfer state-of-the-art technology to developing countries, they can contribute to higher environmental standards and a better work environment.

The economic costs of FDI, where they occur, mostly take the form of unintended side effects. Loss-making enterprises may need to be restructured, with consequent loss of employment. Large foreign-owned companies may take dominant market shares, reducing competition. And the import and export activities of foreign-owned enterprises may lead to balance of payments volatility. But such “costs” are generally of short duration and can be corrected through appropriate host country policy measures.

One of the key conclusions of the OECD report is that the benefits of FDI do not occur automatically: policies in both host countries and home countries matter. Only enterprises that operate in a generally sound national and international environment can bring the full benefits of FDI to bear on the host economy. FDI tends to compound both the advantages and the disadvantages of a country’s business environment. In this context, the report cites a number of specific challenges:

- **For host countries.** The essential need for a sound host-economy business environment applies equally to the case of attracting and benefiting from FDI. Transparency and the rule of law are listed among the top concerns of investors. Another important aspect is the size of the host economy, as evidenced by China’s success in attracting FDI. Even small countries can boost the size of “their” market by pursuing policies of general openness to trade and regional trade integration.

- **For home countries.** Governments in the home countries of investors also have important roles to play. For instance, they need to take account of the consequences of their trade practices for a potential host country’s ability to attract foreign investors.

- **For the enterprise sector.** Foreign-owned enterprises need to comply with high standards of corporate behaviour. OECD governments and other adherents to the OECD Declaration on International Investment and the OECD Guidelines for Multinational Enterprises work with business and civil society to enhance the positive contribution that foreign enterprises can make to economic development.

To obtain a copy of the report, journalists are invited to contact the OECD’s Media Relations Division (request by fax [33 1 45 24 80 03 or news.contact@oecd.org). For further information and comment, they are invited to contact Hans Christiansen in the OECD’s Capital Movements, International Investment and Services Division (tel. [33] 1 45 24 88 17 or hans.christiansen@oecd.org).

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