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Survey of OECD Work  
on International Investment

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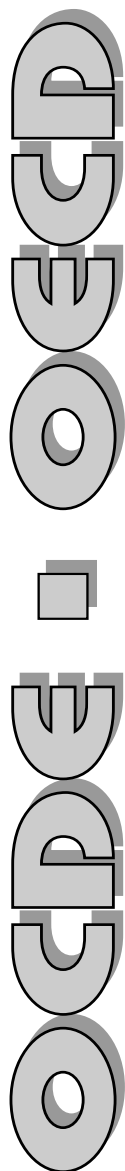
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**WORKING PAPERS ON INTERNATIONAL INVESTMENT**

**SURVEY OF OECD WORK ON  
INTERNATIONAL INVESTMENT**

1998/1

**Organisation for Economic Co-operation and Development  
Organisation de Coopération et de Développement Économiques**



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## **Working Papers on International Investment**

This Working Paper series of the OECD Directorate for Financial, Fiscal and Enterprise Affairs is designed to make available to a wide readership selected studies prepared by OECD staff or by outside consultants working on OECD projects. The papers in the series deal with a range of issues covering international investment, including policies and trends. The Working Papers are generally available only in their original language – English or French – although some may be issued in both languages.

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## **FOREWORD**

This report surveys the findings and conclusions of OECD work and related studies concerning the role of international investment in globalisation and its links with trade and economic development. It has been prepared by the OECD Directorate for Financial, Fiscal and Enterprise Affairs, on the basis of submissions from a number of other Directorates, including Science, Technology and Industry, Development Cooperation and Trade, as well as the OECD Development Centre. An earlier version of this paper was submitted to the WTO Working Group on the Relationship between Trade and Investment in 1997

## TABLE OF CONTENTS

FOREWORD.....	4
INTRODUCTION.....	6
I. TRENDS IN FOREIGN INVESTMENT.....	7
II. THE ROLE OF FDI IN DEVELOPMENT FINANCE.....	11
Prospects for private capital flows to developing countries.....	12
a) Pension fund investment into developing countries.....	12
b) Financial sector liberalisation in emerging markets.....	12
c) Privatisation.....	12
III. THE RELATIONSHIP BETWEEN TRADE AND FDI.....	15
IV. FOREIGN DIRECT INVESTMENT, TRADE AND DEVELOPMENT.....	17
V. THE PERFORMANCE OF FOREIGN AFFILIATES IN OECD COUNTRIES.....	21
VI. THE EFFECTS OF FOREIGN DIRECT INVESTMENT AND TRADE ON EMPLOYMENT AND INCOME DISTRIBUTION.....	23
VII. FOREIGN INVESTMENT AND DOMESTIC COMPETITION.....	25
VIII. MACROECONOMIC IMPLICATIONS OF FOREIGN INVESTMENT LIBERALISATION.....	26
FDI and the balance of payments.....	26
FDI and macroeconomic performance.....	27
Annex 1. OECD Documents and Publications on Trade and Investment.....	31

## INTRODUCTION

International direct investment is increasingly recognised as an engine of economic growth and a powerful force for global integration. The OECD has long been active in analysing the implications of such forces and in influencing the design of appropriate policies for a global economy. This report summarises the findings of recent OECD work on the role of international investment in globalisation and economic development.

Foreign direct investment is defined as capital invested for the purpose of acquiring a lasting interest in an enterprise and of exerting a

degree of influence on that enterprise's operations. Direct investment differs from portfolio investment in that it involves control of the asset in question, while portfolio investors are passive investors, motivated only by the rate of return on the asset. While this distinction is useful for analytical purposes, OECD member countries are increasingly adopting a broader view of FDI which includes many investments otherwise considered as portfolio flows.<sup>1</sup> For this reason, the analysis presented below makes occasional reference to portfolio, as well as direct, investments.

## I. TRENDS IN FOREIGN INVESTMENT

Global flows of FDI have reached record levels in recent years, growing faster than merchandise trade and representing the most important form of foreign capital inflows for many developing countries.<sup>2</sup> Outflows from OECD countries have averaged \$250 billion over the past three years, compared with average outflows of \$110 billion in the previous ten years (Chart 1). Over three fourths of this investment remains within the OECD area. Increased intra-OECD flows have been boosted to a large extent by changes in OECD countries' policies towards FDI (see Box 1). While the non-OECD area has been growing in importance for OECD investors recently, its share of global inflows is still at the level which prevailed before the debt crisis in the early 1980s (29 per cent). An increasing share of these inflows comes from within the non-OECD area itself.

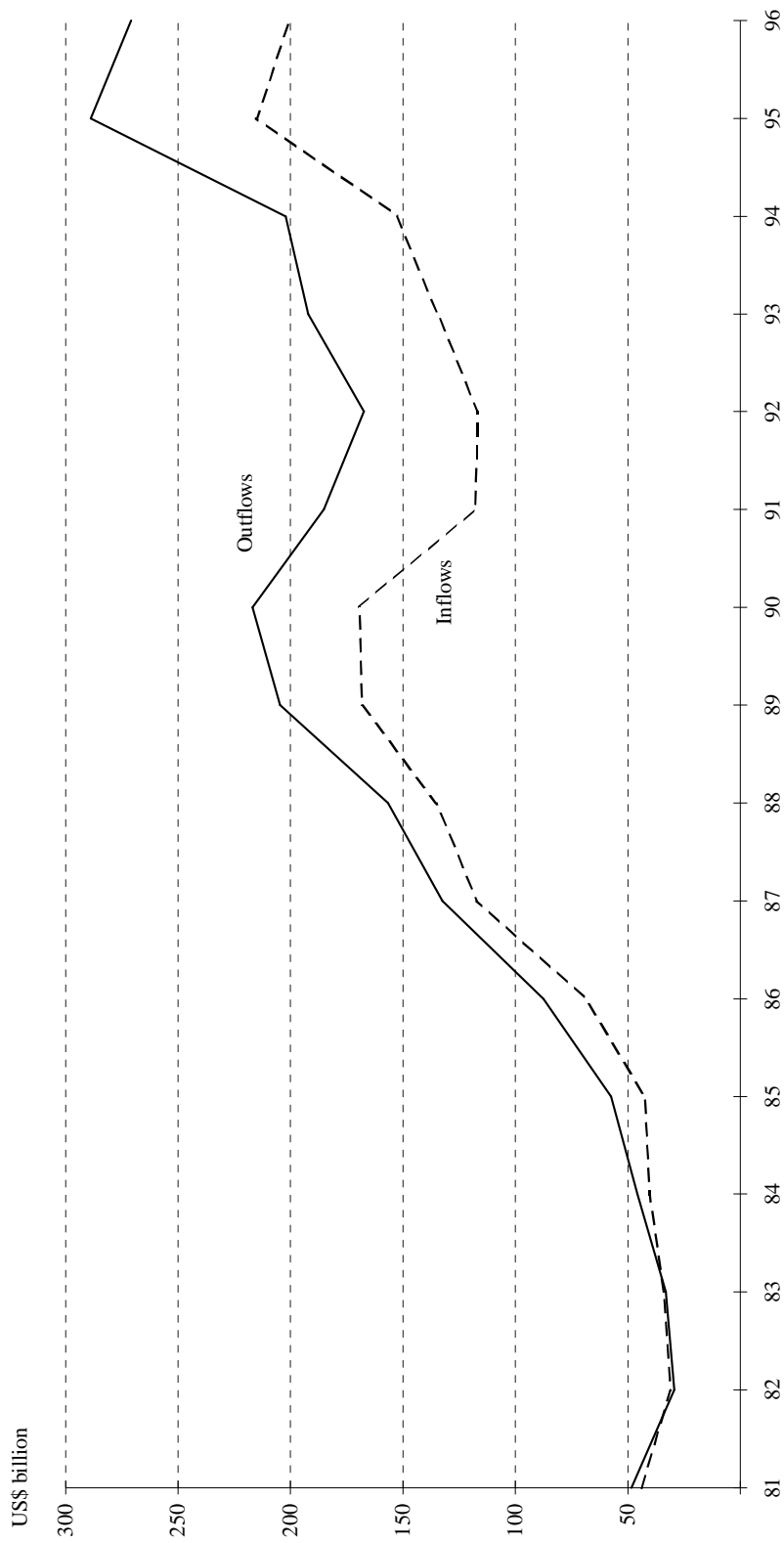
Among developing economies, inflows of FDI have been distributed unevenly. For the

most recent five years for which data is available, the top ten non-OECD recipients took in three quarters of total non-OECD inflows. China alone represented one third of non-OECD inflows (Table 1). This concentration is much more pronounced for FDI inflows than for trade flows, where the top ten non-OECD countries take in 57 per cent of total non-OECD imports.

Developing countries are also becoming more important as home countries for multinational enterprises. Non-OECD outflows have averaged \$30 billion since 1992 and represented one quarter of global outflows in 1994. A large share of this investment has been by firms in Hong Kong into China, but firms from Chinese Taipei, Singapore and even China have also been active. Japanese and Korean firms have also invested heavily within Asia. Intra-regional flows have been increasing in both East Asia and South America and, to a much lesser extent, in Africa.



Chart 1. Total OECD FDI flows, 1981-96\*



\* Includes all 29 OECD Member countries for the entire period.

Source: *International Investment Statistics Yearbook 1996*, OECD

### Box 1. *Liberalisation of FDI in OECD countries*

The second half of the 1980s represented an equivocal watershed for FDI in OECD countries<sup>3</sup>. The period saw a remarkable rise of FDI flows between Member countries, outstripping growth of international trade and domestic capital formation. Just as remarkable was the change in policy approach in many OECD countries which resulted in the removal of many impediments to cross-border capital flows including FDI. Patterns of investment flows also changed: several traditional exporters of direct investment capital became important host countries for FDI as well, while many traditional host countries became increasingly active as investors abroad.

A major factor was the change in attitude towards the role of the State in the economy. Along with sound macroeconomic management, structural policies were introduced to remove supply-side constraints and to boost productive capacity and stimulate economic growth. These policies involved deregulation, privatisation and de-monopolisation on an unprecedented scale, particularly in service-related activities. They brought major reforms in the financial sector, abolition of exchange controls and more integrated financial markets.

The liberalisation of restrictions on foreign investment was an important part of Member countries' new market-oriented policy approach. In addition to job creation and technology transfer, governments became more attentive to the beneficial effects of foreign firms' presence on domestic competition, productivity and competitiveness. The internationalisation of the world economy and the emergence of new markets encouraged the removal of obstacles to outward direct investment so that domestic firms could take better advantage of growth potential abroad.

Liberalisation had a "knock-on" effect as reforms in some countries drew attention to the restrictions of other countries which felt progressively compelled to introduce more liberal policies. Regional initiatives – in particular the Single Market initiative and enlargement of the European Economic Community, and the Canada-United States Free Trade Agreement – also fuelled the process of liberalisation.

During this period, screening mechanisms were simplified or abolished in favour of notification or verification procedures, usually for administrative or statistical purposes, while authorisation requirements were maintained only for politically-sensitive large new transactions or acquisitions. Sectoral restrictions too were abolished or eased, and new sectors or activities were opened to private enterprises and foreign participation. The banking and financial services sector was the primary beneficiary, but other sectors such as specialised telecommunications or broadcasting, under the impetus of new technologies, faced a less restrictive foreign investment regime. Virtually all restrictions on the authorisation and financing of outward direct investment were removed.

Sectoral liberalisation was accompanied by an increasing recourse to reciprocity requirements, especially in finance, transport, basic telecommunications services and infrastructure and public utilities (gas, electricity, water supply, etc.). However the degree of liberalisation achieved has been preserved and further progress has been made in the 1990s.

Table 1. **Total FDI Inflows by Country, 1990-96**

		(US\$ million)
1	<i>US</i>	327 753
2	China	156 342
3	<i>UK</i>	146 671
4	<i>France</i>	124 850
5	<i>Belgium-Luxembourg</i>	68 526
6	<i>Spain</i>	62 737
7	<i>Netherlands</i>	49 881
8	<i>Canada</i>	44 921
9	<i>Mexico</i>	44 806
10	<i>Australia</i>	44 468
11	Singapore	43 362
12	<i>Sweden</i>	38 188
13	Malaysia	30 293
14	<i>Italy</i>	26 534
15	Brazil	23 276
16	Argentina	22 409
17	<i>Germany</i>	21 663
18	Indonesia	20 773
19	<i>Denmark</i>	15 810
20	<i>New Zealand</i>	15 286
21	<i>Switzerland</i>	15 170
22	Thailand	14 148
23	<i>Hungary</i>	12 508
24	Hong Kong	11 639
25	<i>Portugal</i>	11 081
26	<i>Poland</i>	11 075
27	<i>Norway</i>	10 720
28	Chile	10 152
29	Colombia	9 952
30	Peru	9 540

n.b. Definitions of FDI differ greatly across countries.

OECD countries are in italics

Source: OECD, IMF, UNCTAD

## II. THE ROLE OF FDI IN DEVELOPMENT FINANCE

Total private capital flows, of which FDI is just one part, have now become the principal source of development finance. Net annual capital flows from OECD countries to developing countries more than tripled between 1988 and 1996 from \$96 billion to \$307 billion (Table 2). This rise is in part explained by forces underpinning global integration, notably the liberalisation of trade and investment regimes, technological advances in the telecommunications and information sectors and financial market integration. Other factors include the restored financial solvency of debt-distressed countries, progress with structural reform and the transformation of several countries from planned to market economies.

The past decade has been marked by a dramatic reversal in the composition of these flows as between private and public sources. Private capital in the form of FDI, bank credits, bonds and equities increased its share of total flows from 38 per cent to 76 per cent over the period, emerging as a major source of development finance for developing countries. Official concessional finance (of which approximately 70 per cent takes the form of grants) stagnated and its share dropped significantly in the face of expanding private flows.

Shifts also took place among the different components of private capital. Over the period, the share of direct investment remained generally static, averaging approximately 20 per cent of net inflows. International bank lending expanded briskly from 8 per cent to 23 per cent of total flows. The most spectacular rise, however, occurred with bond issues, which have risen from 2 per cent to 28 per cent of the total since 1988. Much of the rise in bond issues is a

consequence of liberalisation following widespread financial repression in the first half of the decade (in the aftermath of the LDC debt crisis). Other portfolio flows broadly kept pace with these developments.<sup>4</sup>

The reasons for the surge in private capital flows can be summarised as follows:

- **FDI** Push factors include enterprise strategies to rationalise production (based on relative factor costs, geographic proximity, organisational change) and enter new or growing markets. Pull factors include widespread liberalisation of foreign investment and trade regimes in developing countries, the adoption of domestic policy frameworks amenable to private sector-led growth, and regional trade and investment agreements (e.g. Mercosur, APEC). Figures understate actual OECD investment in the developing world to the extent that bonds and bank credits have supported investment in infrastructure concessions, Build-Operate-Transfer schemes and their derivatives and privatisation operations.
- **Bank and bond lending** Many countries cut off from international borrowing markets in the wake of the 1980s debt crisis re-established their financial solvency over the past decade as a result of debt relief and restructuring provided through a number of international work-out arrangements. Successful economic reform and growth played a pivotal role in this regard. More recently, bond issues have surged as a consequence of improved information flows, growth and diversification strategies being

implemented by OECD financial market actors and structural trends in financial markets (e.g. debt securitisation).

- **Portfolio flows** Portfolio investment flows have become an important source of development finance in the last five years, as liberalisation in a larger number of developing countries acquired a "critical mass" and OECD Member country institutional investors began more aggressively to penetrate untapped foreign markets.

### **Prospects for private capital flows to developing countries**

In spite of the recent financial crisis in Asia, the prospects for continued high private capital flows from OECD Member countries to developing countries are promising in the long run. Increasing global competition in product and service markets, incentives to reduce costs and produce more efficiently, continuing efforts to increase output and diversify exports as well as the role of new technologies in reducing communication and transport costs<sup>5</sup> all promote global capital flows. Privatisation is attracting foreign investors throughout the developing world. Portfolio flows will be encouraged by a combination of OECD institutional investors' limited exposure to developing country assets, pressures for them to maximise returns and diversify holdings, and financial sector reform and deregulation within developing countries.

#### ***a) Pension fund investment into developing countries***

A recent OECD study argues that the need for higher returns on pensions to fund an ageing population in OECD countries and the superior growth prospects for developing countries will encourage portfolio flows to these countries.<sup>6</sup> Pension fund managers can reap large diversification benefits from investing in emerging stock markets. These benefits, which have so far been largely unexploited, will require

the removal of important regulatory and market barriers. The authors advise regulators in OECD countries to free pension assets from localisation requirements, while governments in emerging markets should design policies that reassure institutional investors on sovereign risk and stock market illiquidity. If these policies are adopted, the study predicts that OECD pension funds will invest about three per cent of their assets (\$350 billion) in the emerging stock markets by the year 2000.

#### ***b) Financial sector liberalisation in emerging markets***

Many emerging market economies have also engaged in major programmes of financial sector liberalisation, both internally and externally. Financial sector liberalisation improves resource allocation and allows for the better management of financial risks. External liberalisation, including removal of barriers to FDI via establishment or acquisition, brings the additional benefits of improved access to world capital markets and the potential to increase the efficiency of the domestic financial sector through inward and outward financial-sector investment, including equity participation and establishment in the financial sector.

#### ***c) Privatisation***

Privatisation, which is intimately linked to foreign investment (see Box 2), has become highly visible in the international economy since 1990. FDI inflows accounted for more than half of infrastructure privatisation revenues in developing countries from 1988 through 1995 (two thirds for privatisations involving telecommunications companies).<sup>7</sup> Privatisations have also been a major vehicle for FDI flows in other areas, as the rollback of State-ownership in the post-communist countries of Central and Eastern Europe and the former Soviet Union, as well as in OECD countries, gained momentum.<sup>8</sup> With privatisation programmes being more comprehensive, records were set in the past two years.<sup>9</sup>

Table 2. Total Net Resource Flows to Developing Countries

	1988	1989	1990	1991	1992	1993	1994	1995	1996 (p)	1988	1992	1996
	(\$ billion)											
	per cent											
I. OFFICIAL DEVELOPMENT FINANCE (ODF)	61.2	60.8	69.5	69.6	70.2	70.2	71.8	71.9	69.5	64.1	53.1	22.6
1. Official development assistance (ODA)(a)	47.6	48.6	52.8	58.6	59.0	56.4	60.5	59.6	57.7	49.8	44.7	18.8
of which: Bilateral disbursements	36.5	36.2	39.3	42.4	41.4	39.6	41.3	40.5	35.4	38.2	31.3	11.5
Multilateral disbursements	11.1	12.4	13.5	16.2	17.6	16.8	19.2	19.1	22.3	11.6	13.3	7.3
2. Other ODF	13.6	12.2	16.7	11.0	11.2	13.8	11.3	12.3	11.8	14.3	8.5	3.8
of which: Bilateral disbursements	7.0	5.3	6.5	4.3	7.7	6.4	7.7	8.2	7.9	7.3	5.8	2.6
Multilateral disbursements	6.6	6.9	10.2	6.7	3.5	7.4	3.6	4.1	3.9	6.9	2.6	1.3
II. TOTAL EXPORT CREDITS	-2.1	9.9	5.0	1.4	0.5	-1.5	6.1	4.8	3.5	-2.2	0.4	1.1
of which: Short-term	2.0	4.8	4.5	-0.8	0.5	-1.5	0.2	0.8	0.5	2.1	0.4	0.2
III. PRIVATE FLOWS	36.4	40.8	48.5	47.6	61.4	64.7	133.5	156.4	234.0	38.1	46.5	76.2
1. Direct investment (DAC)	18.7	23.0	23.5	21.0	23.8	34.5	44.9	50.4	60.0	19.6	18.0	19.5
of which: to offshore centres	6.1	3.1	4.1	5.0	6.2	6.8	6.6	4.0	5.0	6.4	4.7	1.6
2. International bank lending(b)	7.8	10.5	15.0	11.0	31.0	9.0	42.6	60.0	70.0	8.2	23.5	22.8
of which: Short-term	4.0	8.0	7.0	12.0	25.0	7.0	44.0	55.0	60.0	4.2	18.9	19.5
3. Total bond lending	2.0	1.0	0.5	4.9	-0.8	11.4	32.0	30.0	86.0	2.1	-0.6	28.0
4. Other private(c)	3.7	2.3	4.4	5.3	1.4	4.0	8.0	10.0	12.0	3.9	1.1	3.9
5. Grants by non-governmental organisations	4.2	4.0	5.1	5.4	6.0	5.8	6.0	6.0	6.0	4.4	4.5	2.0
TOTAL NET RESOURCE FLOWS (I+II+III)	95.5	111.5	123.0	118.6	132.1	133.4	211.4	233.1	307.0	100.0	100.0	100.0
	<b>Memorandum items</b>											
Total net credits from IMF	-3.5	-1.5	-1.9	1.1	-0.2	0.0	-0.4	13.2	0.2			
Recorded asset transactions by LDCs, net	-19.6	-18.2	-23.6	47.2	6.9	-26.2	-20.1	..				
Interest and dividends paid by LDCs, gross	-90.7	-96.1	-90.9	-86.3	-88.7	-93.2	-91.5	..				
Total official grants	33.5	34.3	45.4	48.2	45.8	44.4	46.1	47.0				
Total intra-LDC flows (ODA)(d)	2.2	1.7	6.0	2.7	1.1	1.1	0.9	0.7				

a. Excluding forgiveness of non-ODA debt for the years 1990 to 1992.

b. Excluding bond lending by banks (item III.3.), and guaranteed financial credits (included in II).

c. No reporting has been received from DAC Members on portfolio equity investment.

d. Not included in total net resource flows.

Source: OECD

## *Box 2. Privatisation and investment*

One can identify three main motives for privatisation: 1) most fundamentally, governments favour privatisation owing to the conviction that privately run companies are likely to be more efficiently managed than state-run companies and that in an increasingly globalised economy, living standards can only be sustained if domestic industry is internationally competitive; 2) privatisation fosters the development of strong domestic financial systems, particularly capital markets; and 3) privatisation will lead to stronger fiscal positions.

Governments have been pursuing comprehensive policies aimed at enhancing efficiency, through deregulation and structural reform, partly to inject more competition into the economy. Reforms often include deregulation of domestic markets and the opening of a growing number of sectors to international competition. Increasingly governments have concluded that while some government-owned companies are comparatively well-managed, it is necessary to hold corporate management responsible for profitability, rather than for the more diverse set of policy goals that characterise state-owned companies.

In addition to promoting competition in product markets, privatisation aims at exposing companies to competitive forces in the financial market. Wider ownership of equity by institutions whose main concern is financial return will encourage a movement towards an "equity culture" in which individual and institutional investors, with access to adequate information, assess and compare corporate management to industry benchmarks.

In private industry, rationalisation to achieve greater productivity and efficiency is partly reflected in mergers, acquisitions and strategic alliances, aimed at developing highly competitive entities with strategic positions in their own industry usually on a global basis. Restructuring and modernisation are increasingly important in key strategic sectors (e.g. telecommunications and air transport), which have until recently been characterised by heavy government ownership and control. Moreover, private companies – especially foreign firms – may be more willing to undertake joint ventures or strategic alliances with an enterprise that is relatively free of state interference.

The distribution of ownership between the government and private investors and between foreign and domestic investors after privatisation will vary depending upon the government's objectives. In some cases, the government retains a "golden share" providing the right to veto certain actions of the company, including takeovers. In others, shares are distributed among a "stable core" of investors. For "strategic" enterprises, restrictions are sometimes imposed on foreign capital, such as ceilings on foreign ownership, limitations on voting rights or on membership on board of directors and management.

Although the motives for engaging in privatisation are similar in OECD and non-OECD countries, some useful distinctions can be made. The most common method of privatisation in OECD countries is through an Initial Public Offering (IPO) on the capital market in which shares are sold to a mix of retail and institutional investors. Generally speaking, capital markets in countries outside the OECD area are less developed and in many cases privatised companies cannot be sold to passive equity investors. Thus, trade sales are frequently used in developing countries and are a very common means of privatisation of large companies (excluding mass privatisation) in former Communist countries. Privatisation by public offerings nevertheless represents a sizeable amount in developing countries where a public offering frequently acts as a catalyst for the development of the domestic capital market.

Privatisation is intimately linked to international investment. Governments will often actively seek a foreign strategic investor who will exercise managerial control and bring know-how and increased efficiency to the company sold and to the economy in general. Indeed, the concept of privatisation through a "trade sale" essentially coincides with foreign direct investment, where the strategic investor is foreign. When foreign investors (along with domestic investors) purchase shares in a privatised company through a public share offering, this is recorded as portfolio investment. Although the portfolio investor (foreign or domestic) does not participate actively in management of the company, the investor normally monitors corporate performance and exercises indirect control through the capital market.

### III. THE RELATIONSHIP BETWEEN TRADE AND FDI

Any discussion of the implications of the relationship between trade and FDI for economic growth and development must first establish a working hypothesis about the nature of that relationship. The prevailing assumption in the work reviewed below is that trade and investment, though different in their nature, effects and policy response, are complementary in several important respects:

- they are two ways for firms to sell abroad;
- they are often driven by a common set of factors such as market size or proximity of the importing or host country;
- they encourage each other in the sense that prior exports facilitate eventual investment and that investment brings with it imports of capital goods and other goods not produced by the local affiliate;
- foreign investment also stimulates exports from the host country, both from the affiliate itself and eventually from local firms; and lastly,
- government policies towards trade have a strong impact on FDI flows and vice versa.

This complementarity has been observed empirically in a recent study of US and French investment flows.<sup>10</sup> Thus for the United States, for example, both inward and outward investment stimulate US exports. Outward investment also promotes imports, while inward

investment has an insignificant dampening effect on imports. The overall effect is one of complementarity. In open economies, any substitution which might occur is most likely to involve trade with third countries, with these markets supplied by the affiliate instead of the home country.

In spite of the prevailing complementarity between trade and FDI, there are differences. Direct investment is generally a long term commitment on the part of the investor to the host economy. Thus, obtaining access to the market through establishment or the ability to acquire local firms satisfies only part of the concerns of the investor. Investors need guarantees that they will be treated fairly and equitably in the future with respect to practically every aspect of domestic regulation. In other words, a foreign investor will typically be concerned with a broad range of policy variables that affect local competitive conditions. Policy issues of specific importance to investment include national treatment of foreign investors and their investments, protection against expropriation, and the right to transfer funds to and from host countries.

From the perspective of the host country, the potential gains from inward investment include: a relatively stable means of financing current account deficits and of transferring technology, managerial skills and other assets belonging to the firm. FDI also allows for gains in skilled employment in higher-valued industries and offers the possibility for export diversification and other effects which influence the competitiveness of the host economy. The activities of multinational enterprises in a host



country also assist in establishing links with foreign markets.

FDI may occasionally substitute for exports in particular cases when an exporter is faced with high barriers to trade. Many countries often combine some measure of trade protection (tariffs, quantitative restrictions, technical standards, etc.) with inducements for firms to invest, with the intention of substituting local production (albeit foreign-owned) for imports. In these cases, the issue for the investor is not one of market access, since the firm is still granted such access as long as it has the means to invest abroad. Rather, it is one of allowing the firm to choose its preferred mode of entry into a market. Box 3 explains how that

preference is shaped by corporate strategies and government policies.

It must also be kept in mind that here is not always a trade-investment alternative. Not all firms have sufficient intangible assets or financial resources to allow them to invest abroad, and not all firms produce goods which can be exported. Some goods are non-tradable because of, for example, transport costs, and many firms sell services rather than goods, often requiring a local presence to do so. For these firms, there is no option of exporting and no direct trade effect in either the home or host country. Many of the benefits of such investment will nevertheless resemble the gains typically deriving from trade.

#### IV. FOREIGN DIRECT INVESTMENT, TRADE AND DEVELOPMENT

Certain developing countries have been highly successful in building a developmental strategy based on foreign investment in their economies. In these cases, inward investment has been associated with rapid industrialisation and a concomitant expansion of increasingly technologically-sophisticated manufactured exports. The benefits of FDI usually manifest themselves in the host country trade performance. Initially, inward investment influences the pattern of trade and the type of goods and services which are exported. Most of these export changes are brought about directly through the activities of foreign MNEs. In the longer term, through transfers of technology and linkages with the local economy, the influence of FDI shows up in the growing competitiveness of local firms in world markets.

A number of OECD studies have looked at the role that FDI has played in industrialisation and hence in economic growth and development in particular host developing economies. A study of Chinese Taipei, Malaysia, Singapore and Thailand concluded that growth in all four countries has been facilitated by domestic policy changes in a more market-oriented direction, including the liberalisation of trade and investment regimes.<sup>11</sup> Foreign direct investment influences growth by contributing new capital and technology. The authors find that investment policy restrictions are very important in discouraging foreign investment, but investment policy incentives are only one variable attracting such investment.

The authors argue that while FDI may “crowd out” local capital in output or input

markets in certain cases, it also provides technology and expertise which is usually missing in a developing economy, thus helping to create – for example through joint ventures and skills training – domestic industrial capabilities which would not otherwise exist. Foreign investors contribute to a foundation for the rise of a local entrepreneurial class drawn from the ranks of local partners and skilled employees.

The extent to which these gains are realised depends on local capabilities, notably related to education and infrastructure, and on the policies which are employed to encourage foreign investment. A recent OECD study of six emerging economies found a strong link between the benefits from FDI and the general policy environment (see Annex 1, item 7).

Trade policies play an important role in this regard. Open trade policies contribute to the attractiveness of each country as a location for MNE production by allowing firms to make use of cheaper inputs from abroad. The foreign dominated electronics industry in Asia, which is highly competitive and internationalised, has contributed greatly to foreign-exchange earnings, employment and skills acquisition in all four Asian countries studied. In Chinese Taipei and Singapore, where educational standards and infrastructure are most developed, this investment has also spawned many local suppliers, competitors and service firms, including independent indigenous enterprises which are highly successful in world markets and which have, in some cases, become multinational themselves.<sup>12</sup>

### Box 3. *Globalisation of industry*

The choice between investing and exporting at the microeconomic level of the firm, and hence the relative importance of trade and FDI flows in the world economy is a function of evolving corporate strategies and government policies towards inflows and outflows of goods, services and capital. An OECD report examines the extent and strategies of globalisation of firms in a number of major industrial sectors.<sup>13</sup> A synthesis of the results is provided in Table 3. The decision to invest or to export will depend on the characteristics of the industry and the policy mix in home and host countries. While exporters rely on domestic factors of production for their competitiveness, foreign investors must have some form of proprietary assets which can be transferred to affiliates abroad. This explains why foreign investment tends to be more important relative to trade in higher technology sectors.

In addition to industry characteristics, government policies have an important influence on the mix between exporting and FDI. Trade barriers influence the pattern of trade, including the relative importance of inter- and intra-regional flows. They may encourage direct investment in the protected market under certain conditions, but the overall effect of trade barriers on the volume of inward investment is ambiguous. While protected markets offer the potential for higher profits for investors, they also raise the costs of imported inputs. They also inhibit the information flows between the two countries through trade which can subsequently encourage direct investment. Given the compelling firm-specific factors promoting outward investment, it is not clear that barriers to trade always have a strong positive effect on the volume of FDI flows.

Whether through trade or FDI, globalisation is one of the major forces driving the restructuring of the world economy. New trends in investment, trade and collaboration between firms have vastly changed the scope of world business and expanded the role of foreign companies in national economies. Firms are engaging in cross-border activities across the whole spectrum of their development, production, supply, marketing and financing activities. This enables them to expand and achieve greater global efficiency.

The OECD globalisation report identifies international direct investment and international collaboration agreements as two important measures of globalisation. The analysis shows that three-quarters of all international investment and most collaboration agreements are between OECD-based firms in OECD countries. R&D- and skill-intensive industries are the main industries driving foreign investment and entering into collaboration agreements, and they are located principally in OECD countries, which also provide their markets.

International trade in the R&D- and skill-intensive industries has risen rapidly and these industries are more trade-intensive than low-technology, low-wage industries except for textiles, clothing and footwear. Most of the high-technology trade takes place among OECD countries. About half of all trade is between firms that are related through equity holdings (intra-firm trade). And high-technology trade is set to expand further as international investment continues to increase. Domestic sales of foreign affiliates have grown even faster than international trade and stand at some 150 per cent of world exports.

The report shows that firms transfer their production to other countries more readily than their R&D and other strategic operations, which they tend to centralise in the home country. The United States, where foreign investment in R&D is found in such high-technology industries as pharmaceuticals, chemicals and communications equipment, provides a major exception. Foreign firms also invest significantly in R&D in some countries where R&D efforts of domestic firms are weak and where market access is important to them.

Globalisation presents major new challenges for policy-makers. The OECD study underlines the need for governments to continue liberalising trade and investment and pursue non-discriminatory practices in the information, technology, and related services areas. It stresses the importance of the local business environment for developing and sustaining industrial competitiveness. Finally, by showing the links between different policy areas, the study demonstrates the need for policy-makers to take an integrated approach when adapting and devising rules to respond to global competition.

Table 3. Industry and government policy influences on trade and investment patterns

	<i>Technological sophistication</i>	<i>Concentration</i>	<i>Trade patterns</i>	<i>FDI patterns</i>	<i>Trade policies</i>	<i>FDI policies</i>
<b>Pharmaceuticals</b>	High	Low	Trade relatively unimportant, mostly involving intra-firm shipments of inputs.	Mergers and acquisitions increasing as industry consolidates.	Markets are segmented by regulations.	Patent protection is sometimes offered as an inducement for firms to invest. The absence of such protection discourages FDI. Relatively high international market penetration.
<b>Computers</b>	High, except for certain hardware.	High	Very trade intensive, particularly inter-regional trade. High share of intra-firm trade in total trade.	Relatively few mergers and acquisitions. Increasing commoditisation will encourage FDI in developing countries.	Few trade restrictions, but recourse to anti-dumping duties in certain major markets.	Governments often sponsor domestic R&D. The effect on FDI will depend on whether principle of national treatment is applied. FDI has been actively encouraged recently in many countries.
<b>Automobiles</b>	Medium -High	High	Above average for manufacturing in trade intensity. Most trade is intra-regional.	Greenfield investments are relatively important. The non-OECD share of production is growing as demand expands in those countries.	Tariffs, quotas and voluntary export restraints have all limited the potential for inter-regional trade.	Political sensitivities limit M&As among major producers. Governments often actively encourage inward investment in this sector.
<b>Consumer electronics</b>	Medium - High	High	Inter-regional trade is decreasing as FDI grows.	Overseas production is a relatively recent phenomenon for many firms.	Anti-dumping duties and other barriers to trade in final goods are common.	
<b>Non-ferrous metals (aluminium)</b>	Low	High, but barriers to entry falling.	One half of aluminium production is exported.	FDI driven by location of raw materials and in order to produce where energy costs are lowest. Also some FDI in the form of risk sharing.		Formerly restrictions on FDI in natural resources in many countries.
<b>Steel</b>	Low	Low	One quarter of steel production is traded.	FDI involves inter-firm alliances and mergers and acquisitions as part of the global rationalisation of the industry.	Governments have been actively involved in the rationalisation of the sector in parts of Europe.	
<b>Clothing</b>	Low	Low	Intra-regional trade is increasing Low intra-firm trade	Little FDI, mostly related to preferential market access	Discriminatory quantitative restrictions (MFA) and high tariffs	

Source: *Globalisation of Industry*, OECD, Paris, 1996.

Openness is not the only trade policy which is used to attract investors. Certain economies with larger domestic markets are able to attract investors by closing off their market to imports. In the automobile sector, for example, which is highly protected in most of the Asian countries in the study, small, protected domestic markets have resulted in high costs and inefficient and uncompetitive – though profitable – firms. Unlike in the electronics industry, where these countries are major players on the world stage both as hosts to MNEs and increasingly also in their own right, the regional automobile industry is still small and will likely remain marginal to the world industry.

These conclusions have been confirmed in OECD studies of other developing countries. Trade liberalisation helps to provide a more competitive location for export and hence may assist in attracting export-oriented foreign investors. In Brazil, for example, an OECD study reports that business and government circles increasingly recognise that strong import protection is a serious handicap to international competitiveness in most sectors of Brazilian industry.<sup>14</sup>

Foreign investment can also contribute to export growth in other ways. For example, MNEs and joint ventures can play a decisive role in the expansion of technologically-sophisticated manufactured exports, given the specific technological advantages they possess. Industry-specific analyses in the Brazilian study suggest that MNEs already play this role in Brazil and that they are likely to continue to so.

The role of FDI in industrial and export diversification comes out clearly in an ongoing OECD study of the role of FDI in development. In Malaysia, for example, foreign investment has

played a key role in economic restructuring, contributing to economic development through its catalytic role in structural changes that have turned Malaysia from an agricultural and primary producer into a manufacturing economy. The relative shares of agriculture and manufacturing in the economy have been reversed since 1960. The structural transformation is even more pronounced if one looks at exports. In 1960, two thirds of Malaysian exports were commodities, primarily rubber and tin, while manufacturing accounted for under nine per cent. By the early 1990s, three quarters of total exports were from the manufacturing sector, principally electronic goods.

The experience of these developing countries suggests that foreign direct investment can play a pivotal role in diversifying a country's exports away from too narrow a focus on a limited number of export markets or products. Under the right conditions, foreign firms can greatly expand the exports of a host country, thus helping to mitigate balance of payments pressures. But experience shows that foreign investors will not necessarily export from their affiliates if the economic conditions in the country in which they are located are not conducive to such exports at competitive prices and with sufficient attention to quality.

Developing country examples provide strong evidence of the synergy between market openness, growth and development. A recent study compares the experience of Southeast Asia (Malaysia, Thailand and Indonesia) with that of African countries.<sup>15</sup> It identifies the opening of markets and a welcoming environment for international investment as two key factors explaining the success stories.

## V. THE PERFORMANCE OF FOREIGN AFFILIATES IN OECD COUNTRIES

Quantifying effects of FDI on macroeconomic variables is difficult because of the multitude of cyclical and structural factors which affect these variables independently of FDI. It is also difficult to establish a satisfactory counterfactual: what would have happened in the absence of the foreign investment? One way to minimise these difficulties is to compare the performance of foreign affiliates in host countries with that of local firms in the same sector. The OECD Secretariat has, for a number of years, monitored foreign affiliate activities in Member countries.

A study of foreign affiliates found that, while the vast majority of differences between the performance of foreign and domestic firms is attributable to differences in structure such as size, sector of activity and degree of internationalisation, it is nevertheless true for the countries in the study that the presence of foreign affiliates improves the performance of the host economy.<sup>16</sup> The study found that productivity growth in foreign affiliates was largely due to increased production capacity, while in domestic firms it was accounted for mostly by labour shedding. Foreign affiliates rely for most of their technology on the parent company, although the share of foreign affiliates in overall research and development (R&D) has tended to rise steadily over time.

In addition to providing quantifiable estimates of the impact of FDI on host countries, the research on foreign affiliate activities also offers an alternative measure to balance of payments data for the extent to which inward investment has become more important in individual host economies. Ongoing analysis

since the OECD study was published suggests several recent trends in this area.

In the countries for which data are available, the share of foreign affiliates in total manufacturing production is higher than in employment, as foreign investment is usually in sectors with high exposure to competition and with high labour productivity. Between 1985 and 1993, foreign affiliates' share of production and employment rose substantially in most OECD countries.

In Canada and Ireland, foreign affiliates account for over 50 per cent of manufacturing production. In the Netherlands, the share of foreign affiliates in manufacturing production exceeds 30 per cent; in the United Kingdom and France it exceeds 20 per cent. In most other countries, it is between 10 and 20 per cent, but it is below 3 per cent in Japan.

Between 1985 and 1993, employee numbers in foreign affiliates in the manufacturing sector rose in most countries, while those of national firms fell sharply. Despite this trend, labour productivity of foreign affiliates rose more rapidly than that of national firms in several countries.

In France, Ireland, Japan and the Netherlands, however, productivity of national firms grew faster than that of foreign affiliates, particularly as a result of employment trends in those firms and affiliates. In Ireland and the Netherlands, employment increased substantially in foreign affiliates but declined in national firms. In France, employee numbers decreased more in national firms than in foreign affiliates,

while in Japan they rose more in foreign affiliates than in national firms.

In 1993, the R&D intensity of foreign affiliates in the entire manufacturing sector was lower or at most equal to the average intensity for the entire manufacturing industry in the host countries, except in Japan and, to a lesser extent, Australia. This result, which contrasts somewhat with the performance of foreign affiliates in fields other than R&D, confirms the assumption that the creation of a research laboratory requires a critical mass of activity that is determined by a number of factors, such as the type of R&D work or the industrial sector concerned. In some sectors where foreign affiliates play an important part, R&D intensity thus exceeds the sector's average intensity at a national level.

- The case of Japan might be explained by the fact that the foreign affiliates on its market are concentrated in some high-technology sectors (mainly computers, electronics and chemicals). Between 1990 and 1992, it is estimated that the R&D expenditures of foreign affiliates rose by a factor of four, while their turnover of national firms rose by

only 20 per cent and their R&D expenditures were down.

- In some countries, virtually all the R&D of foreign affiliates is financed by the affiliates themselves (particularly in Australia and Ireland), but in other cases the parent companies meet a substantial proportion of the funding, especially as the research is often carried out on their behalf.
- The data do not identify the recipients (national firms or foreign affiliates) of funds from abroad. They are nevertheless indicative, when combined with the share of foreign affiliates in R&D. It is very likely that a high proportion of funds supplied from abroad for industrial R&D in Canada goes to foreign affiliates, which account for over 40 per cent of the country's R&D in the manufacturing industry. In Greece, the very high proportion of R&D funds supplied from abroad (over 27 per cent) would rather suggest that these funds go to national firms, considering the small number of foreign affiliates.

## VI. THE EFFECTS OF FOREIGN DIRECT INVESTMENT AND TRADE ON EMPLOYMENT AND INCOME DISTRIBUTION

The relationship between employment and income distribution (or relative wages of different types of labour) and globalisation is one area where trade and investment issues are most closely related. Workers in both OECD and non-OECD countries sometimes express concern that increased imports from lower wage countries are harming their own earnings prospects. Outsourcing by local firms from their affiliates abroad (hence through FDI) plays an important role in this process. When a firm shifts production abroad, it is presumed to have a direct effect on domestic employment in that sector and an indirect effect on relative wages in the home country through the increased imports which flow from affiliates in lower wage locations.

The first thing to point out is that MNE motives for investment abroad are generally to gain more effective access to local or regional markets in which the affiliate is located.<sup>17</sup> The outsourcing of production to supply the home country market, to the extent it occurs, is more likely to involve production within the geographical region of the home country, such as the *maquiladora* plants of American and other firms in Mexico to supply the US market or the production by small German manufacturing firms in the Czech Republic to supply German clients.<sup>18</sup>

Concerning the impact of an increase in trade with low wage countries, some of which is intra-firm trade, on the relative wages of unskilled workers in the home or importing country, economic theory predicts that lower skilled workers in the capital rich country will face a decline in their relative wages as a result

of trade with relatively more labour abundant countries, while labour abundant countries should see an increase in the relative wages of unskilled workers. A number of studies, including some undertaken in the OECD, have sought to establish whether relative wage shifts have occurred and the extent to which trade with low wage countries has influenced this phenomenon.<sup>19</sup>

The demand for unskilled labour has shrunk dramatically in OECD countries, resulting in either a decline in relative wages or increasing unemployment among this section of the labour force. The OECD Jobs Study and many similar studies conducted elsewhere have found that this phenomenon is more the outcome of technological progress in certain sectors than it is the result of greater trade with poor countries.<sup>20</sup> Because greater competition stemming from globalisation has provided a spur to technological progress, the distinction between the two effects may be less than these studies imply. Furthermore, because globalisation affords higher incomes at an aggregate level, it will affect production and consumption in each country and hence will have indirect income effects on the demand for labour, including for unskilled workers.<sup>21</sup>

Foreign direct investment is one of the mechanisms by which production is shifted to lower wage countries. The available evidence does not point to a major direct impact on jobs and wages in OECD countries stemming from this outflow to developing economies. Some researchers have found evidence to suggest that developments in relative labour costs matter more for foreign direct investment among



countries with a similar level of development and, in particular, countries with a common regional trading area. This does not exclude the possibility that delocalisation from OECD to non-OECD countries in some cases has been undertaken with a view to reduce labour costs, but it raises doubts about the importance of that phenomenon in the wider picture.<sup>22</sup>

To a certain extent, the debate over delocalisation misses the point about foreign direct investment. It assumes that there is a fixed demand for labour and hence once production is shifted abroad it reduces the demand for labour at home and creates unemployment. Instead, FDI is a dynamic process with its strongest impact on the *type* of employment at home and in foreign affiliates. Outward investment is one way in which a firm remains competitive and hence able to maintain employment levels in the home country – in both domestic production and in headquarters services (management, research and

development, etc.), while creating new jobs abroad.

When a firm shifts production from the home country to another country with lower unit labour costs, it is performing an important function in the global economy. From the firm's perspective, it is known as the product cycle. For the countries concerned, it is structural transformation. This process would occur even without the multinational enterprise. Outward investment merely facilitates this adjustment process. The benefits accrue not only to the firm but also to both the home and host countries, in spite of short term adjustments in the labour markets which may be of special concern at a time of high unemployment in certain home countries. Indeed, some of the most successful non-OECD economies at attracting investment have actually encouraged certain, more labour-intensive activities to transfer abroad. This is particularly the case for certain East Asian economies such as Singapore.

## VII. FOREIGN INVESTMENT AND DOMESTIC COMPETITION

The OECD experience shows that foreign investment can enhance the level of competition in domestic markets and hence economic efficiency to the benefit of the host country. By bringing new players able to challenge market positions of already established enterprises, foreign greenfield investments and mergers and acquisitions provide incentives for domestic enterprises to adjust in order to remain competitive. Participation of foreign investors on a national treatment basis in bids for concessions provides a guarantee that such concessions are granted on the best terms and conditions. Also, the faculty of domestic enterprises to borrow directly from foreign banks abroad exerts helpful pressure on domestic banks to reduce the cost of their services and extend the range of credits they offer; similarly, the opportunity given to domestic enterprises to raise funds on international capital markets incites stock market institutions to improve the functioning and the attractiveness of local capital markets.

There may, however, be situations where foreign investments reduce competition in the domestic market. In particular, if the investment is through the acquisition of a domestic producer by a foreign firm already exporting into that

market, competition may be reduced through increased concentration. The presence of foreign firms in a domestic market may also complicate the task of the national competition authority, particularly if cartel activity is suspected, as information necessary to the investigation of a cartel is spread across the jurisdictions of several countries.

The possibility that a foreign firm would acquire and then abuse a dominant position in a domestic market is not a reason to hamper FDI. Anti-competitive practice is neither an inherent or exclusive behaviour of foreign investors. Abuse of a dominant position by any firm, foreign or domestic, can usually be controlled by national competition authorities with the necessary enforcement powers, particularly provisions requiring pre-merger notification and prohibiting anti-competitive mergers and seeking the co-operation of competition authorities in other countries. Removal of remaining discriminatory restrictions on entry of foreign firms can greatly help the task of national competition agencies in this regard, as the entry of additional firms is the best long-term strategy to prevent the acquisition of excessive market power.

## VIII. MACROECONOMIC IMPLICATIONS OF FOREIGN INVESTMENT LIBERALISATION

Concerns have been expressed that foreign investment liberalisation may adversely affect the balance of payments and macroeconomic stability. First, the net contribution of foreign investment to the host country's balance of payments could become negative over time if profits are systematically repatriated abroad rather than reinvested locally or if foreign-controlled enterprises display a greater propensity to source abroad than domestic firms. Second, it has been noted that, if the inflow of capital becomes very large, it may complicate the conduct of monetary and exchange rate policies and in particular the implementation of macroeconomic stabilisation programmes: large capital inflows may put upward pressure on the real exchange rate. Depending on the monetary policy setting, this would be the result of either nominal exchange rate appreciation or higher inflation. In both cases, the current account deficit is likely to deteriorate – sometimes leading to deficits that are larger than desirable. Lastly, it has been pointed out that excessive reliance on external financing may make the economy, its banking sector in particular, vulnerable to sudden reversals in financial market conditions abroad and in foreign investors' sentiment, as evidenced most recently in Asia. These concerns are addressed separately below.

### **FDI and the balance of payments**

For any given investment project, repatriated profits once the affiliate is profitable may exceed initial inflows of equity capital in the long run. The investment will usually be sustained by the retained earnings of the affiliate.

Based on this notion of the investment cycle of a foreign investment project, it has been argued that FDI may lead to a deterioration in the balance of payments position of the host country over time. Such reasoning is flawed for several reasons. First, FDI also affects the balance of payments through the trade account, with net exports from the affiliate potentially offsetting net capital outflows. In the short term, an investment is likely to be accompanied by an increase in imports of capital goods from the home country as the investor establishes a production facility. In the longer term, however, the investor is likely to begin to export from the host country, provided host country policies are such that the affiliate is able to compete with producers elsewhere. The net effect on the balance of payments from these offsetting current and capital account flows is difficult to determine *a priori*.

Second, the experience of an individual investment project is not the full story. Foreign direct investment is a continuous process: as some older investors begin to repatriate profits, new arrivals inject additional equity capital into the host economy and existing investors expand their presence through retained earnings. Both forms of investment are recorded as capital inflows in the balance of payments.<sup>23</sup> Third, more important than the actual direct effect of inward investment on the balance of payments is the long term indirect benefit derived from transfer of technology and know-how to domestic producers. These transfers improve the overall ability of the host country to export and hence allow the economy to sustain greater inflows of foreign capital over time. To focus only on the direct impact on the balance of

payments of individual investments misses these important indirect gains to be derived from inward investment.

### **FDI and macroeconomic performance**

The concerns raised above with respect to private capital flows into developing countries have received much attention recently, especially given the turmoil in Southeast Asian financial markets. Before discussing the role which FDI might play in macroeconomic stability, there are several general points which need to be made. First, greater international capital mobility improves global resource allocation by directing world savings to its most productive uses, allows recipient countries to maintain stable levels of investment and consumption in spite of fluctuations in their income, and sends important signals to host countries concerning the sustainability of their policies. With appropriate economic policies which do not distort the flow of capital into particular areas, these inflows allow the host economy to sustain higher growth rates than would otherwise have been possible.<sup>24</sup> Second, domestic investors may contribute more to capital flight than foreign ones when economic conditions deteriorate.<sup>25</sup> Third, capital controls impose a cost on the domestic economy through the inefficiencies which they engender.<sup>26</sup> The OECD experience with capital movements liberalisation is presented in Box 4.

Foreign direct investment may appear as just another form of private capital flow in the

balance of payments, but it differs in important ways from other forms of investment, and this has implications for the issues discussed above. Evidence suggests that FDI is less likely to raise such problems than other types of capital inflows. Direct investment involves much more stable and generally smaller amounts of capital than portfolio investment and credits. Because the transaction costs, and therefore the risks involved, are considerably higher when an investor establishes an enterprise compared to the purchase of short-term Treasury bills for example, greenfield direct investments represent long-term, carefully selected investment projects which cannot be liquidated at short notice. Furthermore, direct investment most often takes the form of equity capital, which, as opposed to debt creating instruments, imposes no obligations on the debtor to make fixed interest payments and to reimburse the principal at a determined date; a foreign investor may be unable or unwilling to liquidate his shares unless he can find a counterpart willing to buy them at the desired price. Finally and perhaps even more importantly, in the absence of perfectly fluid financial markets and substitutable financing instruments, direct investment can be expected to contribute to the financing of productive investment in a higher proportion overall than portfolio investment and credits, thereby enhancing the host country's capacity to assure the service of its debt through increased exports at a later stage.

#### Box 4. *The OECD experience with the liberalisation of capital movements*

When confronted with “capital inflow” problems, a number of OECD countries were, in the past, inclined to resort to restrictions on foreign investment. Such restrictions generally did not apply to foreign direct investment, however. Furthermore, OECD countries progressively dismantled their capital controls as international integration of financial markets and domestic financial reforms progressed, more efficient indirect monetary policy instruments were developed, more flexible exchange rate arrangements were adopted and macroeconomic policies conducive to long-term price stability were given priority.

In retrospect, the OECD experience has shown that capital controls create important inefficiencies, often become ineffective in the longer run and cannot substitute for consistent macroeconomic policies and necessary structural and institutional reforms. On the contrary, capital controls may give the authorities a false sense of security and distract them from their essential task of maintaining sound fiscal and monetary policies and a realistic exchange rate and of pursuing reforms over the medium term. Capital controls should be conceived at best as transitory measures to buy time to take more fundamental adjustment policy measures in order to redress the situation.

Indeed, while foreign investors and international markets have sometimes tended to “over-react” to events, creating interference with otherwise desirable policies, difficulties arising from capital inflows in OECD countries most often were associated with situations where foreign investment had been attracted primarily by the prospects of high short-term interest rate differentials in a context of fiscal slippage, misaligned exchange rate targets and tight monetary policy. Such macroeconomic configurations were unlikely to be sustainable, and foreign investment was accordingly unlikely to represent a long-term commitment on the part of foreign investors. Also a “too” large share of short-term investment commitments in total capital inflows often reflects a legitimate reluctance of traditionally risk-averse foreign investors, such as pension funds and insurance companies, to take long-term, less liquid asset positions. This is especially the case with respect to host countries where property rights remain uncertain due to accounting and bankruptcy law deficiencies or where the stock market is not functioning properly. Attention should also be given to the fact that foreign investors’ focus on short-term investment may sometimes reflect a lack of opportunities for longer-term, direct investment due to restrictions aimed at protecting national ownership.

The experience of OECD countries has shown that the full macroeconomic benefits of foreign investment, including FDI, can best be realised if sustainable and credible macroeconomic policies are already in place, or are put in place as rapidly as possible. A well-supervised and efficient financial sector is also important because this sector may have to absorb capital inflows and outflows as well as rapid and large changes in financial market prices, such as exchange rates and interest rates. Economic flexibility more generally is also helpful in the context of liberalised financial markets, as the benefits of such liberalisation can be limited if product and labour markets fail to adjust smoothly to changing economic conditions. The availability of high quality and timely information is also important to improve investor decision making and to bolster confidence in government policy making.<sup>27</sup>

## NOTES

1. Both the OECD Benchmark Definition of FDI (Third edition, OECD, 1996) and the IMF Balance of Payments Manual recommend that the possession by an investor of ten per cent or more of the ordinary shares of a corporate enterprise be the criterion used to establish effective control. However, the OECD Code of Liberalisation of Capital Movements (OECD, 1997) uses a broader definition, and the Multilateral Agreement on Investment (MAI) currently under negotiation at the OECD may cover nearly all forms of investment.
2. OECD investment statistics are published annually in the *International Direct Investment Statistics Yearbook*. Recent trends are analysed in the June issue of *Financial Market Trends*. There are a number of methodological problems associated with FDI data. Countries' data on outflows and inflows frequently do not match, in part because countries treat retained earnings differently. Other problems arise from fluctuations in intra-company transactions (in particular lending) and the role of tax havens and offshore banking centres. Finally, exchange rate changes affect the statistics because of their impact on stocks and flows when converted into a common currency. These difficulties do not, however, invalidate the analysis of this section.
3. *International Direct Investment: Policies and Trends in the 1980s*, OECD, 1992.
4. Development Assistance Committee (DAC) statistics reflect net capital flows (e.g. after interest, dividends, capital repayments, etc. have been deducted). Equity flows are significantly understated in the table, since a number of major source countries (United States, United Kingdom and Japan) do not report these flows.
5. See *The World in 2020: Towards a New Global Age*, OECD, 1997.
6. "Pension fund investment: from ageing to emerging markets", Policy Brief No. 9, OECD Development Centre, 1994.
7. *The World in 2020: Towards a New Global Age: Challenges and Opportunities*, OECD, 1997.
8. *Privatisation in Developing Countries: Reflections on a Panacea*, Policy Brief No. 3, OECD Development Centre, 1992.
9. See Special Feature in *Financial Market Trends* n° 66. OECD information on privatisation is based upon the analytical work of the Secretariat, mainly of the Directorate for Financial, Fiscal and Enterprise Affairs (DAFFE). For a number of years, the Committee on Financial Markets has maintained contacts with market participants and with responsible officials in Member countries and has especially stressed the role of financial markets in privatisation. Other relevant groups include the OECD's privatisation network which brings together regularly senior officials from privatisation institutions in Member countries, managers and information gatherers.
10. "The links between foreign direct investment and trade: empirical evidence for US and French industries", *STI Working Papers*, OECD, forthcoming.
11. Linda Lim and Pang Eng Fong, *Foreign Direct Investment and Industrialisation in Malaysia, Singapore, Taiwan and Thailand*, OECD Development Centre, 1991.
12. *Ibid*, p. 175.
13. *Globalisation of Industry: Overview and Sector Reports*, OECD, 1996.
14. Winston Fritsch and Gustavo Franco, *Foreign Direct Investment in Brazil: Its Impact on Industrial Restructuring*, OECD Development Centre, 1991.
15. See *The World in 2020: Towards a New Global Age*, OECD, 1997.
16. *The Performance of Foreign Affiliates in OECD Countries*, OECD, 1994.

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17. OECD *Economic Outlook*, December 1996, p. 24.
  18. "The Policy Challenges of Globalisation and Regionalisation", Policy Brief n° 11; OECD Development Centre, 1996; *Globalisation and Regionalisation: The Challenge for Developing Countries*, OECD Development Centre, 1994; *New Forms of Investment in Developing Country Industries*, OECD Development Centre, 1989.
  19. See R.E. Baldwin, "The effects of trade and foreign direct investment on employment and relative wages", *OECD Economic Studies*, 23, 1994; J.-P. Cotis, J.-M.-Germain and A. Quinet, "Technical progress, international trade and low-skilled labour:", *OECD STI Review*, 18, 1996; R.Z. Lawrence, *Single World, Divided Nations?*, OECD Development Centre, 1996; P. Messelin, "The impact of trade and capital movements on labour: evidence on the French case", *OECD Economic Studies*, 24, 1995.
  20. *Employment Outlook*, OECD, July 1997, Chapter 4.
  21. These arguments were presented in a speech by Kumiharu Shigehara, Deputy Secretary-General of the OECD, entitled "Globalisation, technology and jobs", in London, 4 July 1997.
  22. *Ibid*, p. 8-9.
  23. Under the balance of payments accounting identity which states that the current account balance must be equal to the difference between savings and investment, FDI can increase capital formation or provide additional financing for the balance of payments but cannot perform both functions simultaneously.
  24. Estimates suggest that overall the annual gains arising from the mobility of international capital are on the average of the order of at least 1 percentage point of GDP, and possibly larger . See "Regulatory Reform in the Financial Services Industry: Where have we been? Where are we going?", in *Financial Market Trends*, No.67, June 1997.
  25. Jeffrey Frankel and Sergio Schmukler (1996), "Country fund discounts and the Mexican crisis

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of December 1994: Did local residents turn pessimistic before international investors?" International Finance Discussion Papers, Board of Governors of the Federal Reserve System, Washington.

<sup>26</sup>. See OECD (1993), *Exchange Control Policy*, Centre for Co-operation with European Economies in Transition.

<sup>27</sup>. See "Emerging Markets and the Liberalisation of Capital Movements", in *OECD Economic Outlook*, No. 58, December 1995.

## Annex 1. OECD Documents and Publications on Trade and Investment

### 1) General

*OECD Economic Outlook*, June and December issues

“Emerging Markets and the Liberalisation of Capital Movements”, in *OECD Economic Outlook*, No. 58, December 1995.

### 2) Foreign Direct Investment Policies, Trends and Statistics

Special Feature on Recent Trends in Foreign Direct Investment, *Financial Market Trends* (June issue, 1994-97)

*International Direct Investment Statistics Yearbook* (1997)

*OECD Benchmark Definition of Foreign Direct Investment: Third Edition* (1996)

“The effects of trade and foreign direct investment on employment and relative wages”, *OECD Economic Studies*, 23 (1994)

*Exchange Control Policy*, Centre for Co-operation with European Economies in Transition (1993)

*International Direct Investment - Policies and Trends in the 1980s* (1992)

*Foreign Direct Investment and Industrialisation in Malaysia, Singapore, Taiwan and Thailand*, OECD Development Centre, (1991)

*Foreign Direct Investment in Brazil: Its Impact on Industrial Restructuring*, OECD Development Centre, (1991)

“The links between foreign direct investment and trade: empirical evidence for US and French industries”, *STI Working Papers*, OECD, (*forthcoming*)

### 3) Foreign Direct Investment Reviews

Argentina (1997), Denmark (1995), Finland (1995), France (1996), Greece (1994), Ireland (1994), Italy (1994), New Zealand (1993), Norway (1995), Portugal (1994), Sweden (1993), Switzerland (1996), United States (1995), Chile (1997), Brazil (*forthcoming*)

### 4) Trade and Investment

*Open Markets Matter: The Benefits of Trade and Investment Liberalisation*, (1998)

*Employment Outlook*, OECD, (July, 1997)

*Market Access After the Uruguay Round, Investment, Competition and Technology Perspectives* (1996)

*Single World, Divided Nations?*, OECD Development Centre (1996)

*Trade, Employment and Labour Standards* (1996)

*Trade and Investment Interface* (1996) (available on the Internet)

“Technical progress, international trade and low-skilled labour”, *OECD STI Review*, 18 (1996)

“Globalisation, Trade and Competition” *The OECD Observer* No. 201 of August-September



“Emerging Markets and the Liberalisation of Capital Movements”, in *OECD Economic Outlook*, No. 58 (December, 1995)

“The impact of trade and capital movements on labour: evidence on the French case”, *OECD Economic Studies*, 24 (1995)

*New Dimensions of Market Access in a Globalising World Economy* (1995)

*Foreign Direct Investment, Trade and Employment* (1995)

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