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### **New Horizons and Policy Challenges for Foreign Direct Investment in the 21<sup>st</sup> Century**

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#### Foreign Direct Investment in Developing Countries: Determinants and Impact

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#### **I. Introduction**

Perhaps much more is written on Foreign Direct Investment (FDI) in the development process than any other aspect of development.<sup>1</sup> This should be of little surprise; the characteristics of FDI, its rapid growth and pivotal role in the process of globalisation in recent years, its intimate relationship with trade, and its historical antecedents have all attracted the attention of economists, political scientists, economic historians and in recent years management specialists and anthropologists. The principal characteristic of FDI, which sets it apart from other sorts of international capital flows, is the control over operations exercised by the investing entity over the investor entity. Ownership of equity and more importantly command over technology and know-how enable firms to exercise control over operations. It is control over operations that enables foreign firms to transfer technology and know-how to the recipients of FDI. And FDI is a potent instrument of development because of its ability to transfer technology and skills to developing countries.

Several developments in the global economy since the decade of the eighties have softened the opposition to FDI and rekindled faith in its ability to promote development. Indeed, suspicion and distrust of foreign firms seems to have yielded place to a newfound faith in their ability to promote growth and development objectives. A number of factors have influenced this change in attitudes including increased familiarity with the operations of MNEs, reduced flows of alternative sources of finance such as bank credit and foreign aid and the demonstrable success of several developing countries with FDI. . Further, the information technology revolution has wrought dramatic changes both with respect to the channels through which technology and know how is transmitted and its impact on the technology absorptive capacity of host entities.

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1 Surveys include Aggarwal 1980, de Mello 1996, Balasubramanyam and Sapsford 2000.

Thus although voices of dissent and opposition to FDI continue to be heard, principally from the critics of Globalisation (Noorena Hertz, 2001), the challenges facing policy makers in developing countries are now of a different order than those during the decades of the sixties and the seventies. Briefly put, it is how best to attract substantial volumes of FDI and utilise it effectively in the promotion of development objectives. Effective utilisation of FDI involves not only maximisation of the benefits of FDI but also minimisation of its costs, for FDI is not without its social costs. One of the enduring worries of host countries with FDI is the exercise of control over decision making by foreign firms. The recent growth in mergers and acquisitions (M&As), as opposed to green field investments, of locally owned firms has heightened these worries. For acquisitions by definition involve the take over of existing locally owned firms by foreign firms and the surrender of control over operations by the former to the latter.

This paper addresses two interrelated issues of concern to developing countries; factors which determine FDI flows and the preconditions for the efficient utilisation of FDI in the development process. Section II of the paper discusses the principal determinants of FDI. Section III analyses the necessary pre conditions for the efficient utilisation of FDI in the development process. Section IV identifies issues for further discussion.

## **II. Determinants**

The extant theoretical and empirical literature on determinants of FDI yields the following broad propositions<sup>2</sup>.

1. Host countries with sizeable domestic markets, measured by GDP per capita and sustained growth of these markets, measured by growth rates of GDP attract relatively large volumes of FDI
2. Resource endowments including natural resources and human resources are a factor of importance in the investment decision process of foreign firms.
3. Infrastructure facilities including transportation and communication net works are an important determinant of FDI.
4. Macro economic stability, signified by stable exchange rates and low rates of inflation is a significant factor in attracting foreign investors.
5. Political stability is conducive to inflows of FDI
6. A stable and transparent policy framework towards FDI is attractive to potential investors.
7. Foreign firms place a premium on a distortion free economic and business environment.
8. Fiscal and monetary incentives in the form of tax concessions do play a role in attracting FDI, but these are of little significance in the absence of a stable economic environment.
9. Regional groupings and preferential trading arrangements between prospective recipients of FDI may induce increased inflows.

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2 Langhammer, R. (1991), Levis, M. (1979), Schneider, F. and Frey, B. (1985).

10. Foreign direct investment which enables investor entities to exercise control over operations is the preferred method of foreign enterprise participation for most investors. Licensing agreements and joint ventures are usually exceptions dictated by exceptional circumstances.

These propositions, some of which may overlap others, are anchored in theoretical insights and a variety of statistical studies. Here we comment on some of the significant propositions, without engaging in an exhaustive review of the literature.

### *Size of Markets*

Size of markets and sustained growth of markets are an obvious attraction to profit maximising firms. Most statistical studies on the determinants of FDI in developing countries attest to the importance of size of markets.<sup>3</sup> (Balasubramanyam and Salisu 1991, Dunning, 1973, Agarwal. 1980) The theory underlying this proposition is that firms which possess advantages such as a new technique of production or even a well known brand name (known in the literature as ownership advantages), require sizeable markets both at home and abroad in order to maximise returns to their investments in generating the unique advantages they possess. Although markets abroad can be serviced through exports, tariffs and trade restrictions may be a barrier to exporting. Also the physical presence of the firm in the market would facilitate acquisition of market intelligence. Investments which are attracted to host countries because of the size of markets are known as market seeking investments (Dunning , 1993)

It should be added that not all FDI is domestic market oriented. There are also export market oriented investments both in relatively large countries such as China and small economies such as Mauritius. The attraction of these countries for foreign firms is their resource endowments including cheap but efficient labour. Investments which seek such endowments are referred to as resource seeking FDI (Dunning, 1993). Yet another variety of FDI referred to by Dunning as efficiency seeking FDI may also respond to relatively low wage costs in developing countries. Efficiency seeking investments consolidate and rationalise market seeking and resource seeking investments which companies may have undertaken in the past. Such investments may result in an international division of labour, with capital intensive segments of the production processes and products located in the developed countries and the labour intensive processes and components located in the developing countries. In some cases FDI may be undertaken in locations with cheap labour for the assembly of components and parts. It should be noted that in these types of labour seeking investment it is not just low wage costs, but it is the efficiency wage or low wages coupled with relatively high productivity which counts in the investment decision process of foreign firms.

### *Infrastructure*

The significance of infrastructure facilities as a determinant of FDI needs no elaboration. Infrastructure facilities are to be defined broadly in this context to include not only transportation and communications but also a favourable environment for work and leisure. These are vital for any sort of investments be they foreign or domestic. Illustrative in this context is the experience of India's Software industry. Whilst the industry requires little by way of transport facilities, the firms in the industry are dependent on the satellite facilities for exporting their wares. Also one of the often cited reasons for the clustering of software firms, including foreign owned firms, in the south Indian city of Bangalore is the ambience of the city, with excellent facilities for school level education and sports and recreation facilities. (Balasubramanyam and Balasubramanyam, 2000)

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3 Per capita GDP should be measured in terms of purchasing power parity exchange rates to provide an accurate measure of the size of markets.

### ***Macroeconomic Stability***

Low inflation rates and stable exchange rates are important determinants of FDI for more reasons than one. First they attest to the stability and the underlying strength of the economy. Second, they provide a degree of certainty relating to the future course of the economy and impart confidence in the ability of firms to repatriate profits and dividends. Weak economies with high levels of domestic borrowing and debt, measured by the ratio of budget deficits to GDP and total volume of borrowing to GDP, are often compelled to institute exchange controls and controls on the capital account of the balance of payments. Third, more often than not a stable macro economic environment also implies a stable political environment. Political and economic stability are usually intertwined (Balasubramanyam and Salisu, 1991).

### ***Product and Labour Market Distortions***

One of the most significant determinants of FDI is a distortion free economic environment. Admittedly, a stable macro economic environment presupposes a distortion free environment. A distortion free environment though has specific implications for trade and investment policies. Distortions in product and factor markets are said to occur when product and factor prices deviate from their true social opportunity costs. For example wage rates for labour in the manufacturing sector may exceed that which it can earn in an alternative occupation such as agriculture. Again domestic market prices for goods and services may exceed those for comparable imports and prices for exportables may be lower than that for comparable goods sold on the domestic markets. These distortions are mostly policy induced in the sense that minimum wage policies and restrictions on imports in the form of quotas and tariffs and subsidies for exports serve to distort market prices away from their true social opportunity costs.

A predictable consequence of such distortions is the misallocation of resources and investments away from sectors and activities in which the country possess a competitive advantage. Such distortions also have an impact on the volume of FDI host countries are able to attract. For long it was the received wisdom that restrictions on imports in the form of tariffs and quotas would induce increased flows of FDI. This belief is based on the proposition that trade and capital flows are substitutes for one another and a restriction on trade would induce firms to invest in the protected markets. (Mundell 1957) Recent research, however, suggests that trade and FDI complement one another and need not necessarily be substitutes (Greenaway and Milner, 1988) Also, countries with a distortion free market environment, free of policy induced incentives and restrictions, tend to attract relatively large volumes of FDI than distortion ridden economies. We owe a precise enunciation of this proposition to Jagdish Bhagwati of Columbia University who argued that

"With due adjustments for differences among countries for their economic size, political attitudes towards DFI and political stability, both *the magnitude of DFI inflows and their efficacy* in promoting economic growth will be greater over the long haul in countries pursuing the export promotion (EP) strategy than in countries pursuing the import substitution (IS) strategy" (Bhagwati 1978)

Several features of Bhagwati's hypothesis are noteworthy. First, is the reference to the trade policy framework of countries host to FDI. The inward looking IS strategy, pursued with vigour by countries such as India until recently, is exemplified by tariffs and quotas on imports, and in many cases restrictions on spheres of activity and volumes of investment by both domestic and foreign investors. Quite often, IS regimes are also characterised by subsidies on exports, a sort of second best policy to promote exports, but the protection from import competition afforded to import substituting industries exceeds the incentives for exports provided by subsidies. The policy orientation of EP regimes, as defined by Bhagwati, is its

neutrality. In other words, the policy regime favours neither the production of import-substitutes nor exportables, on average tariffs on imports match the subsidies on exports. Resource allocation in an EP regime would be dictated by market forces and the dictates of comparative advantage as opposed to the policy induced investments in the IS regime. In general EP regimes tend to be relatively free of policy induced distortions.

Tariffs on imports do attract FDI into the protected industries, but ultimately they will not be as large as that attracted by EP regimes. This is because incentives offered by the IS regime tend to be artificial, in the sense that they are often designed to compensate for the lack of location specific advantages, and their continuation is subject to the whims of the policy makers. Foreign firms wary of unexpected policy changes are unlikely to commit large volumes of FDI in IS countries. And FDI that is attracted by restrictions on imports, the tariff jumping variety of FDI is likely to be transient, lasting as long as the artificial policy induced incentives. Statistical evidence in favour of these propositions is robust (Balasubramanyam and Salisu 1981, Balasubramanyam, Sapsford and Salisu, 1996)

### ***Incentive Schemes***

Apart from trade policies most developing countries offer a variety of subsidies to foreign firms. These include tax holidays, tax concessions and exemptions from duties on imports of parts and components and export duties. The ubiquitous export processing zones found in most developing countries are also designed to attract FDI. It is doubtful if these incentives weigh heavily in the investment decision process of foreign firms. The evidence on the issue is not conclusive. (Guisinger, 1986) Developing countries may be compelled to offer such incentives only because their competitors for FDI offer them. If none of the countries offer such incentives the location decision of FDI would be based on the resource endowments of host countries and the climate for efficient operations they provide. Most such incentives are tied to performance requirements of one sort or the other. Given the nature of these incentives and the fact that each of the host countries offer such incentives only because others do so, it is likely that they are yet another source of distortions in the market for FDI.

### ***Integration Schemes***

Much is written on the impact of regional integration schemes and preferential trading arrangements on FDI, mostly in the context of the EU and the NAFTA. Whilst the impact of such arrangements between developing countries on FDI is yet to be investigated in detail, there is little reason to argue that integration schemes per se induce increased flows of FDI. In general integration schemes allow for free trade between member countries, but restrict imports from third countries. The free trade element serves to enhance the size of markets whilst the tariff element impedes imports from third countries into the region. Both these effects are likely to induce increased inflows into the region. The received wisdom though is that the market enlargement effect is much more significant than the tariff effect in inducing increased flows of FDI. Furthermore, it is policies designed to eliminate distortions and liberalise trade and investment, which often either precede or accompany integration arrangements, which are likely to induce increased flows of FDI. Integration per se may have little effect on the volume of FDI members of integration schemes are likely to attract. (Blomstrom and Kokko, 1997). Here again the factors of significance in attracting FDI are liberalised trade and investment regimes and removal of product and factor market distortions.

### ***Methods of Foreign Enterprise Participation***

In the past several developing countries such as India and Brazil attempted to have their cake and eat it too. Technology licensing agreements with foreign owned firms and joint-ventures were seen as methods of

importing technology and know how without at the same time yielding control over operations to foreign entities. The characteristic feature of licensing agreements is the absence of ownership of capital on the part of foreign firms and hence control over operations. Foreign firms entering into such agreements with locally owned firms provide management services, technical information or both in return for an agreed upon fee and royalties. Although seemingly attractive to both parties licensing agreements pose a number of organisational problems, most of which arise from the imperfections in the market for knowledge. First is the ever-present threat of imitation and loss of monopoly over rent yielding advantages firms possess. Knowledge is a public good in the sense that once produced the volume of it does not diminish with use. It can be replicated at very little cost, in other words the marginal cost of replicating knowledge is far below the average cost of producing it. Second, there are problems associated with the pricing of technologies; purchasers of technology would be reluctant to name a price in the absence of information on its nature and characteristics and sellers would be loath to impart such information lest they lose their monopoly over their assets. Third, most complex technologies cannot be effectively transferred in the absence of involvement in operations through asset participation and managerial control on the part of the owners of technology. In the face of these and other market imperfections FDI is the preferred option for the exploitation of the rent yielding advantages firms possess. Most theoretical explanations for the birth and growth of MNEs are cast in terms of market imperfections (Buckley and Casson, 1991) MNEs overcome such imperfections by internalising operations from production to sales i.e. by forging backward and forward linkages. They effectively bypass the market as it were and confine operations to the internal bureaucracy of the firm.<sup>4</sup> It is sufficient to note here that in general FDI is the preferred method of foreign enterprise participation for most firms.

FDI is undertaken either through green field investments or through M&As. Although M&As are a phenomenon of significance in the developed countries, around one third of FDI flows to developing countries in recent years is an account of acquisitions (UNCTAD, 2000). Much of these acquisitions are in Latin America followed by East Asia. Whilst privatisation programmes account for the growth of acquisitions in Latin America, the East Asian ones are a result of the financial crisis in these countries. As stated earlier, M&As have heightened developing country worries concerning surrender of control over operations to foreign firms. They also pose interesting issues concerning their efficacy in promoting development objectives relative to green field investments.

Whilst we discuss their implications for efficacy in section III, M&As also have an impact on the volume of FDI countries are able to attract. It is often argued that M&As, as opposed to green field investments, result in very little new investments, only a transfer of ownership of existing assets from locally owned firms to foreign owned firms. This may be fallacious for two reasons. First, moneys paid by the foreign firms to the locally owned firms may be invested elsewhere in the economy by the latter. Second, the essence of FDI is the technology and know how it transfers to the host economy. And most though not all locally owned firms that are acquired are ailing firms, on the verge of bankruptcy, which require infusion of technology and managerial know how if they are to survive. The concern relating to control over decision making arises in the case of both green field investments and acquisitions. But in the case of acquisitions control is surrendered by the locally owned entities to the foreign firms and it is this sense of having to surrender that which was in ones possession which arouses antipathy to acquisitions. It is, however, worth noting that relatively liberal policies governing acquisitions do not necessarily attract large volumes of FDI. Local firms are acquired by foreign firms mostly because of relatively easy access to assets of one sort or the other including marketing channels and R&D facilities. In the absence of assets, which can be, restructured and refined acquisitions are unlikely to materialise.

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4 See Buckley and Casson (1991), Dunning (1993) and Caves (1982).

### *Attitudes and Business Environment*

The list of determinants of FDI discussed here may seem exacting, but they are not insuperable. Most of the determinants of FDI are policy driven. Admittedly, resource endowments, including natural resources and labour, are beyond the control of policy makers. But not all FDI is of the resource seeking variety, and labour can be trained and organised through appropriate education and training policies. The most significant determinants of FDI, which are amenable to policy, include the institution of distortion free product and factor markets. These can be achieved, as several developing countries in East Asia and elsewhere have demonstrated, through openness to trade and investment and abolition of domestic policies which impede competition in the market place. Another important determinant of FDI is transparency and stability of policies towards FDI. Frequent changes in policies relating to the spheres of activity of foreign firms, fiscal and exchange rate policies are unlikely to inspire confidence on the stability of the host economies on the part of foreign firms.

Facts and figures on the volume and pattern of FDI in developing countries reflect the significance of the determinants discussed here. The volume of FDI flows to developing countries has increased substantially over the years (Table 1). Several factors referred to earlier have contributed to the observed growth of FDI. Those which rank high among these factors are a dramatic change in attitudes towards private enterprise participation in general and FDI in particular, growing familiarity with the operations of MNEs and most importantly the embrace of liberal trade and investment policies by most developing countries. Even so, FDI continues to be the preserve of a select few developing countries. Much more than 65 per cent of the total stock of FDI at the end of the year 2000 was in no more than eight developing countries including (Table 4). The picture does not alter much even after the economic size and other attributes of host countries are taken into account.

Most of the high achievers in the FDI stakes are also high up in the growth and income league tables. Arguably, FDI may itself may be one of the factors which has contributed to their growth. Even so, FDI has to be accumulated over the years to reap its rewards in the form of technology, know-how and contribution to trade. There could be little dispute that, apart from the infrastructure facilities they provide, it is the business environment in these countries which has enabled them to attract relatively high volumes of FDI. Business environment is many faceted, it includes not only attitudes towards foreign enterprise participation but also the quality of the bureaucracy and its ability to implement policies, the structure of incentives, efficient financial and legal institutions and a stable macro economic environment. Admittedly these are characteristics of relatively rich developing countries and the developed countries.

Even so, many of these factors are policy driven. Instituting the sort of policies conducive to an attractive business environment though is fraught with problems. Institution and development of a stable and attractive business environment is contingent upon what is referred to as the three Cs- Commitment, Competence and Consensus (Economist, 1992). Top level policy makers must be committed to instituting liberal trade and investment policies, the bureaucracy must be capable of implementing the policies and there should be a consensus between various interest groups. Of the three, commitment and consent may be the most difficult, most developing countries have the competence to institute the relevant policies.

Local business interests, politicians and bureaucrats and the elite or the opinion makers in the host countries may not always consent to the sort of policies required to attract high volumes of FDI. In this context the contrasting experience of China and India is instructive. China has successfully attracted substantial volumes of FDI compared with its equally populous neighbour India. Average annual inflows of around \$2 to 3 billion of FDI India has attracted in recent years pales into insignificance compared with \$40 billion China has attracted (Table 5). Perhaps, China is able to attract high volumes of FDI because policy makers are not constrained by lack of consensus, they are able to impose consensus rather than seek and promote it. It is also likely that distrust and suspicion of FDI is much less of a problem when more

than three quarters of FDI flows are from the Chinese Diaspora resident in neighbouring Asian countries. The battery of incentives afforded to foreign firms in the eastern coastal regions of China including the export processing zones and a faith in the ability of FDI to promote trade and incomes suggests a high degree of commitment to liberal FDI policies. (Wei and Liu, 2001)

India too liberalised its trade and FDI regime in the year 1991. Although India's average tariff rates continue to be as high as 35 per cent, there has been a considerable loosening up of tariffs on a variety of intermediates and components and the domestic industrial licensing system has been abolished. India has also watered down her objections to majority equity participation by foreign firms and has attempted to streamline the foreign investment approval process. All this suggests commitment. Even so, the volume of FDI in India is relatively low. India is yet to erase its traditional image of hostility to private enterprise and FDI. Policy pronouncements may be ineffective in the face of opposition from the elite and opinion makers, powerful lobbies and reluctance to implement agreed upon policies by the bureaucracy. The much publicised problems associated with the Enron power project in the State of Maharashtra is illustrative in this context. Attitudes towards FDI apart, India's stringent labour laws, cumbersome procedures for approval of foreign investment projects notwithstanding protestations to the contrary, and political exigencies which compel the party in power to cater to entrenched interest groups are all factors in the low volumes of FDI India has attracted.

It is also to be noted that piecemeal liberalisation efforts may not be successful in attracting FDI. For instance, a reform package which liberalises the foreign trade regime but leaves factor-market distortions untouched, as in the case of India, may be of little attraction to investors. A liberalised trade regime may encourage competition in the market place, but faced with labour legislation which restricts hiring and firing of labour, foreign firms may opt to service the market through exports from their home base rather than through FDI. In sum, promotion of a business environment conducive to foreign enterprise participation requires not only competence but also commitment and consensus, a configuration of the three is not easily achievable.

### **III. Efficacy of FDI**

High volumes of FDI alone do not contribute to the social product. Needless to say the contribution of FDI to growth and development objectives including dissemination of technology and know-how, promotion of trade and employment creation is conditional upon its efficient utilisation. In many cases, the private rates of return to investments made by foreign firms may exceed their contribution to the social objectives of the host countries. Here again it is the policies of the host countries and the business environment they provide which influence the outcome. In general, the preconditions necessary for attracting FDI are also the ones which determine its efficacy in promoting growth and development objectives. The principal propositions concerning the efficacy of FDI can be grouped into two; those which are anchored in trade theory and those embedded in growth theory, principally the endogenous growth theory (Romer 1990, Lucas 1988). Here we identify the principal propositions.

1. FDI is not a panacea for the development problem, it is a catalyst of growth and development
2. The type of trade policy regime in place influences the allocative efficiency of FDI.
3. Competition in the market place is an essential precondition for the effective utilisation of FDI.
4. Incentive packages and various sorts of regulations imposed on foreign firms may not always be conducive to the efficient operations of foreign firms.

### ***FDI is not a panacea for the development problem, it is a catalyst of growth***

As discussed earlier FDI is attracted to locations with a developed infrastructure and endowments of cheap but efficient labour. Foreign firms seek resources which can be combined with the ownership advantages they possess. In the process they augment and develop host country resources. They build upon the endowments in host countries in their bid to maximise the rent yielding advantages they possess. FDI is thus most effective in the presence of co-operant factors. This insight though not a revelation, we owe to statistical studies of the impact of FDI on growth rates of host countries. (Blomstrom, Lipsey and Zejan 1995, Balasubramanyam, Sapsford and Salisu 1999) The statistical studies suggest that a threshold level of human capital needs to be in place in the host countries before the growth enhancing effects of FDI can be unleashed. Such a threshold level of human capital is to be found mostly in the more developed amongst the developing countries. And it is for this reason statistical studies suggest that FDI is most effective in promoting growth in countries which have achieved a threshold level of development.

The explanation for these observations is that countries host to FDI must be capable of absorbing the technology imparted by foreign firms, a process which may also entail restructuring imported technologies to suit local factor and product market conditions. Profit maximising firms would neither be willing nor able to undertake the substantial investments in establishing infrastructure facilities and initiating education and training programmes. They would, however, build upon that which already exists.

Threshold levels of human capital may, however, exist in specific segments and sectors of economic activity even in relatively poor countries. FDI can be socially efficient in these sectors provided it is afforded a distortion free business environment, unencumbered by restrictions and regulations. An excellent example of such FDI is the foreign investments in India's software sector, which consists of both wholly foreign owned subsidiaries and joint ventures. Here the resource sought by foreign firms is not unskilled labour but skilled labour proficient in the production of software. And for the most part such investments are export oriented. They are designed to exploit the genuine comparative advantage India possesses in the production of software. The managerial and marketing skills foreign firms provide assist the country in exploiting its human capital endowments, a result of past investments in education. Apart from the technology embodied in the computer hardware they import, foreign firms also transmit what is termed as tacit knowledge or human skills. The mix of the two depends on their size and market orientation (Siddharthan and Nollen, 2000). Diffusion of such skills in the economy takes place with the frequent movement of software engineers from one company to the other and also when they opt to set up their own companies.

### ***Trade Policy Regimes and Efficacy of FDI***

The main contribution of standard theories of international trade is that free trade is a positive sum game, it confers gains on all the trading partners. The gains are two fold; specialisation gains and exchange gains. The former arise from allocation of resources and specialisation in production based on comparative advantage of the trading countries and the latter from an opportunity to trade at a set of prices different from that in autarchy. Standard trade theories also demonstrate that in general policy induced interference in free trade in the form of tariffs and quotas on imports would result in a misallocation of resources and loss of efficiency gains from trade. Resources will move from the production of exportables into the protected and the relatively profitable importables. Restrictions on imports may, however, induce inflows of foreign capital including FDI into the production of importables. The issue then is whether or not such tariff jumping variety of FDI is socially efficient from the point of view of the host countries. The consensus on the issue is that whilst such tariff jumping FDI may be profitable from the point of view of the foreign firms it may not be socially profitable for the host country. Foreign firms would enjoy markets sheltered from import competition and reap substantial rewards for their investments. The host country,

however would lose because of (a) presence of FDI in areas of activity in which it does not possess comparative advantage (b) protection induced misallocation of domestic resources away from lines of activity in which it enjoys a comparative advantage and loss of specialisation gains from trade (c) payment of profits to foreign owned factors of production. In general, tariff induced inflows of FDI would immiserise growth (Bhagwati, 1973).

Admittedly, FDI in the import competing industries may contribute to skill formation and technological change. But these sorts of dynamic gains from FDI are uncertain. Foreign firms would have little incentive to invest in development of skills and technology in the presence of highly profitable markets, sheltered from international competition. FDI can generate dynamic advantages only in the presence of an appropriate climate for investment, which is free of factor and product market distortions. In the presence of sheltered markets and tariff induced distortions, foreign firms may rest content with tried and tested technologies and evince little interest in promoting managerial efficiency. The technology they transfer to the import competing industries may not suit the factor endowments of the host country, for it would be in industries in which the country does not possess a comparative advantage. Several statistical studies endorse the proposition that the tariff jumping variety of FDI not only results in the importation of technologies which are not appropriate to the factor endowments of host countries but also results in social rates of returns which are well below the private rates of returns to foreign investors (Lal 1975, Balasubramanyam 1973). In other words, the country would have been better off importing the products than making them at home with the tariff jumping variety of FDI.

A number of statistical studies have investigated the comparative export performance of locally owned and foreign owned firms and spillovers of technology and skills from foreign owned firms to locally owned firms, in countries such as Morocco, India and Mexico. (Kumar, 1990, Haddad and Harrison, 1993, Blomstrom and Persson, 1983, Blomstrom and Kokko, 1998) Whilst these studies yield a mixed bag of conclusions, it is fair to say that in the presence of protected domestic markets and absence of effective competition both the export performance of foreign owned firms and spillover effects tend to be low.

In general, FDI which exploits the innate comparative advantage which host countries possess contributes to efficient resource allocation and specialisation and trade. This is not to say that the only variety of FDI which is socially efficient is of the trade promoting variety. It is just that allocation of FDI between import competing activities and export promoting activities should be guided by comparative advantage and market forces free of policy induced distortions. This is the message of Bhagwati's hypothesis, referred to earlier, which argues that FDI is much more efficacious in EP countries than in IS countries. Note that the hypothesis does not rule out production by foreign firms for the domestic market, provided that such investments are guided by distortion free market forces. Statistical evidence in support of this proposition is robust (Balasubramanyam, Sapsford and Salisu, 1966).

### ***Competition in the Market Place and Efficacy of FDI***

The foregoing discussion has centred mainly on the static or allocative efficiency in the presence of FDI. Much more significant are the dynamic benefits FDI can confer on host countries. Such dynamic benefits, which can shift the growth path of host countries on to a new trajectory, include spill overs of production technology and know how from foreign owned firms to the rest of the economy, production of new knowledge and product innovations with investments in research and development. Growth theory, in its recent incarnation referred to as the endogenous growth theory, provides rich insights into the sort of dynamic benefits FDI can provide and the preconditions necessary for the generation and dissemination of such benefits. There are two issues of concern here: what are the factors which contribute to the generation of new knowledge broadly defined to include technology, managerial know how and labour skills and what

are the factors which promote the diffusion of such knowledge from the producers to the rest of the economy.

In the traditional literature technological change is usually assumed to be exogenous. In other words, there are no specific explanations for its generation and diffusion. Also increased investments in capital formation meet with diminishing returns to capital. The so-called endogenous growth theory contests these propositions. Technical change can be endogenous in the sense that firms compete with each other on the basis of new cost reducing methods of production and innovations designed to produce new and differentiated products. Those in the lead capture markets and retain their market shares until imitators of their products and processes appear. The emergence of competition spurs renewed research and development efforts. Technical change is associated not only with physical capital but also human capital. Learning by doing, learning by doing what others are doing and investments in education all contribute to the growth of productivity of labour. Now if labour productivity increases *pari passu* with investments of capital per unit of labour diminishing returns to capital will be arrested. Note worthy here is the role of competition in the market place which spurs investments in knowledge creation. It is competition and its threat to the monopoly over advantages which firms possess which compels them to create new knowledge. It is the necessity to keep one step ahead of competitors which promotes investments in R&D and innovations. These observations hold true of foreign firms in developing countries too. Competition from imports and from locally owned firms provides the incentives for foreign firms to generate new knowledge.

It is again competition which serves to disseminate or diffuse technology and know how. Knowledge once produced is non-rivalrous in the sense that the use of it by one entity does not preclude others from using it. Technology can be imitated by rivals, human capital or skilled labour may move between firms and knowledge can be diffused through various sorts of linkages between firms. Foreign firms may establish locally owned suppliers of components and parts and impart the technology and know-how required to produce such components. This they may do either because such sub-contracting of the production of components is cost effective or because of host country initiatives in establishing such sub contractors. (UNCTAD 2001).

An illuminating early case study of a multinational enterprise in India provides evidence of diffusion of technology and know how through linkages between the MNE and local suppliers. As the study states "these inter industry linkages also entail a variety of other relationships whereby skills, technological information and capital are transferred, production co-ordination is achieved in uncertain and narrow markets, and prices are negotiated when free competition is not feasible " (Lall, 1983). These sorts of technology diffusion the study reports were found to occur even in the protectionist environment in India in which the MNE was operating. Effective competition in the market place would no doubt have sharpened and extended such linkages.

It is also worth noting that whilst individual firms may meet with diminishing returns to investments in knowledge creation, diffusion and spillovers of knowledge may serve to promote productivity and efficiency at the level of the aggregate industry and the economy. Insights derived from the new growth theory endorse the dynamic benefits FDI is capable of generating, but the precondition for the generation and diffusion of knowledge on the part of foreign firms is effective competition in the market place. It should be added that spillovers of knowledge or externalities from FDI do not materialise automatically. Apart from effective competition in the market place, appropriate policies for the dissemination of knowledge and its absorption by the recipients have to be instituted. These include provision of information on the sources of know how, investments in education and training of labour, efficient financial institutions which can provide resources for potential suppliers of components and parts to foreign firms and government support as opposed to needless intervention.

### ***The Policy Framework and Efficiency of FDI***

In most developing countries FDI is subject to an array of rules and regulations. There are also a number of incentive schemes including tax exemptions, tax concessions and various sorts of subsidies designed to attract FDI. These are collectively referred to as Trade Related Investment Measures (TRIMS). Export Processing Zones (EPZS) also known as Free Trade zones (FTZS) to be found in most developing countries can also be included under this head. Firms located on these zones are allowed to import equipment and parts free of import duties and exports from the zone are also exempt from export duties. They are trade related as they impact on international trade at one remove or the other. For instance, Local Content Requirements (LCRS) which stipulate that foreign owned firms should source a specific proportion of their components and parts from local resources would restrict imports. Again, the requirement that foreign owned firms should export a certain percentage of their exports if they are to enjoy majority ownership of equity has also an impact on trade.

These measures are supposed to serve several objectives - garner the maximum possible benefits from the operations of foreign firms to the host countries, satiate the desire of bureaucrats to retain power and control, provide local businessmen a complementary role in the operations of foreign firms and in some cases protect them from foreign competition. In other words, these measures ostensibly allow host countries to exercise economic sovereignty over the operations of foreign firms. In some cases, TRIMS are also designed to offset policy-induced distortions elsewhere in the economy. Export subsidies and equity regulations tied to exports are an attempt to offset the attractions of a protected domestic market, so too are the EPZs pervasive in developing countries.

An extensive body of literature has analysed the impact of these measure on the productive efficiency of foreign firms and their welfare consequences for the host countries (Greenaway 1991, Balasubramanyam 1991, UNCTAD, 2001). Although there is a case for the regulation of FDI, the impact of these measures on the economic welfare of host countries is at best uncertain and at the worst negative. For instance, in the absence of cost effective suppliers of components LCRS may increase the costs of production of foreign owned firms and reduce efficiency. Foreign firms may react to such regulations by withdrawing their investments and servicing the host country markets through exports. If they do continue with their operations they may pass on the increased costs to consumers through higher prices for the products they sell. LCRS imposed on export oriented foreign firms may impair their efficiency and price competitiveness in international markets. For instance, exports of foreign firms in the automobile sector of India are reported to have increased substantially following the liberalisation of imports of automobile components in the year 1991 compared with their performance when they were compelled to rely on domestic sources (Narayanan,1998).

TRIMS such as those which tie equity participation to exports, are equally problematic. These are imposed for narrow balance of payments reasons and not for broader development objectives. In the presence of distortion free markets, comparative advantage and market forces would guide the investment allocations of foreign firms. Equity oriented export requirements are put in place to offset distortions elsewhere in the economy, which provide artificial incentives for production oriented towards domestic markets. These restrictions hardly fulfil development objectives. A foreign firm, which does not wish to comply with equity restrictions, may dilute its equity in favour of indigenous suppliers and opt to produce for the protected domestic market. And indigenous capital, whose social opportunity costs could be considerable, will also be oriented towards the protected domestic market. The net result is the creation of rents in protected markets for both the foreign owned and domestically owned firms. And it would also result in a reduction in trade. There are also instances where foreign owned firms are allowed 100 percent ownership of equity if their entire output is exported. Suppose that export prices are lower than that prevailing in domestic markets and foreign firms service both markets. In this case foreign firms operating in the protected domestic market would have an incentive to bridge the price difference between the two markets

by raising prices on the domestic market. In essence domestic consumers would provide an export subsidy to the foreign firms

All this is not to say that TRIMS is toto are weak instruments for promoting development objectives and they should be prohibited. Well designed TRIMS which take into account domestic supplier capabilities and nurture locally owned firms with investments in education and training do result in the development of local suppliers and create jobs. But TRIMS which are ostensibly designed to promote development objectives, but are in practice no more than devices to delimit control over operations by foreign firms may be counter productive. Indeed, TRIMS which serve to promote competition in the market place are to be encouraged, for as said earlier it is effective competition which spurs efficiency.

M&As discussed earlier also raise specific issues relating to competition and efficacy of FDI. The concern here is that acquisitions concentrate economic power in the hands of foreign firms and limit competition. The inevitable restructuring of operations of the acquired firms may result in loss of jobs and in some cases a transfer of specific managerial functions and R&D from the host countries to the locale of the foreign firms. The available evidence on these issues, exhaustively analysed by the UNCTAD, is inconclusive. Admittedly an acquisition results in increased control over decision making in the hands of foreign firms. But to the extent the firm continues to service the market competition in the market place would not be eliminated, which indeed would be the case if the firm were to go bankrupt. According to the UNCTAD survey the other concerns such as loss of jobs are real, but in the long run the net impact of M&As on jobs and exports do not differ much from that observed in the case of green field investments. But how long is the long run is a legitimate question. It is for this reason appropriate competition policies which safeguard local interests without at the same time restricting efficient operations of the acquired firms a re crucial.

In sum. it would be a folly to expect profit maximising firms, be they foreign or locally owned, to specifically address development objectives of host countries. They do contribute to development objectives if and only if the business environment is conducive to efficiency of operations. As Paul Streeten puts it " it is not sensible to transfer income by attempting to transform the MNE from what it is -a profit seeking animal-into something it is not-a public service (Streeten, 1971). In the final analysis as IMD Little noted early on in the debates on FDI--- FDI is as good or as bad as the host country policies.

#### **IV. Issues for Debate**

The foregoing has merely skimmed the copious literature on FDI and noted the main issues. Most of this is what may be termed received wisdom. In recent years though the debate on globalisation, with FDI being the prime force of Globalisation, has tossed up several new issues have emerged. Three issues figure on most agendas on globalisation. First of these relates to labour standards and the MNE. Second is the argument that the MNE and FDI contribute to the degradation of the environment. Third is the longstanding thesis, which has surfaced again in the debates on globalisation, that FDI deprives developing countries sovereignty over economic policy, concentrates economic power in the hands of foreign owned firms and poses a threat to local interests. Here we merely identify the issues at debate for further discussion.

The issue of labour standards has several strands to it. First, there is the widespread concern that wage rates in poor countries are abysmally low compared with what labour earns in developed countries and this amounts to exploitation of labour. Second, is the concern that profit maximising MNEs adopt dual standards in their labour policies. The standards they set for wage payments and labour welfare in developing countries fall far short of the standards they adopt in their home countries. Third is the concern that practices such as employment of child labour is morally reprehensible. There is no dispute that

exploitation of labour including child labour is socially undesirable and must be eliminated. The issue though is what is a just wage? Is the theoretical precept that wage rates reflect the opportunity cost of labour, what it can earn in alternative occupation, and that the opportunity cost for labour is close to zero in poor countries, is much too glib an explanation for the low wages in poor countries? Is it right to say that if MNEs do adopt dual standards on labour welfare, they are not to be blamed, the blame should rest with host country governments and the absence of labour legislation in these countries? Is it legitimate to argue that labour standards are culture specific and it would be injudicious to transplant developed countries standards into developing countries? Is child labour an economic phenomenon born out of poverty, inefficient credit markets, and lack of education (see Jafarey and Lahiri (2001) for an excellent discussion of Child Labour) and the MNEs passively react to prevailing labour market conditions?

The issue of the environment and the MNEs too has several strands. Do MNEs move production facilities to countries with lower standards? Do lower standards in some countries force other countries to follow suit in order to protect their competitive advantage in trade and investments. Is it legitimate to impose developed country standards on poor countries? The environment issue appears to be much more tractable than the labour standards issue. Evidence in favour of the first proposition appears to be weak. In the face of widespread concern for the environment, which is a global problem, MNEs wish to be seen as good citizens keen on protecting the environment (Bhagwati, 1995) Most MNEs invest in technologies which preserve and promote the environment. Whether or not the concern for the environment on the part of MNEs is born out of self interest rather than altruism is arguable, but they can't be accused of deliberately seeking locales with low standards. There is no reason to suspect that poor countries blithely ignore the need to preserve the environment and let loose the MNEs to despoil it. Their concerns though may be different than that of the developed countries, they may accord priority to objectives such as access to safe drinking water rather than the preservation of non-renewable resources. And imposing uniform standards on poor countries may be injudicious. Even so, there are issues relating to the environmental obligations of MNEs, institution of incentive structures which promote the environment and whether or not trade and investment policies should be geared to the preservation of the environment.

The thesis that FDI and MNEs pose a threat to the economic sovereignty of host countries, undermine interests of locally owned entities and concentrate economic power in the hands of foreign firms is an old refrain. Indeed, the variety of issues relating to FDI all centre on the objective of host countries to garner the maximum possible benefits from FDI without at the same time yielding control over decision making to foreign firms. But control over operations, which in turn facilitates transfer of technology and know how and efficient operations is the key characteristic of FDI. This dilemma has resurfaced in recent years with the growth in FDI and one of its modalities- mergers and acquisitions (M&As) of locally owned firms. As said earlier M&As mostly relate to FDI in developed countries, where they account for the bulk of FDI flows. In developing countries M&As account for around a third of total flows, although there are wide regional variations. Amongst the several factors which motivate M&As the most significant one is the desire to acquire assets of one sort or the other without having to invest in building them up from scratch. This is the asset seeking sort of FDI discussed earlier. The costs and benefits of such FDI to host countries is an area yet to be investigated in detail. Available evidence, however, suggests that the impact of M&As on competition in the host countries may not be much different from that in the case of green-field investments. Both of these two types of FDI may eliminate competition and in many cases they can also promote competition. The relevant issue for discussion here though is the design of appropriate policies which serve to mitigate the costs of M&As and maximise their benefits to host countries. It is worth pondering whether or not a set of universal rules and regulations, with derogations where necessary, may be superior to country specific policies and bilateral agreements.

Indeed, there may be a case for instituting FDI on the agenda of the WTO. In fact, bits and pieces relating to FDI have been incorporated in the WTO. These relate to the agreement on trade in services, TRIMS and trade related intellectual property rights (TRIPS). Most trade in services require the presence and

establishment of the suppliers of services in the locale of the consumers, in other words FDI. Moreover, MNEs account for a substantial proportion of world trade, the central concern of the WTO. It may not therefore require a giant step to include FDI on the agenda of the WTO in a much more cohesive fashion than at present. Even so, the proposal is likely to arouse controversy both because of the ever present worries and concerns regarding FDI and the recent suspicion and distrust of the WTO on the part of the opponents of globalisation. There may be legitimate grounds for urging a reform of the WTO centring on the concerns of developing countries and the promotion of their development objectives. But to say the institution is fundamentally flawed and it is designed to promote the interests of developed countries is an exaggeration.

In sum, FDI in developing countries poses a variety of issues most of which arouse intense debate. This paper has identified some of these issues and reviewed the major insights from the vast literature on the subject. Its modest objective is to identify issues for discussion and not present settled conclusions.

## Annex of Tables

Table 1. **Stock of Inward Foreign Direct Investment by Host Region and Economy**  
(US\$ billion)

<b>Host Region / Economy</b>	<b>1980</b>	<b>1985</b>	<b>1990</b>	<b>1995</b>	<b>1999</b>	<b>2000</b>
<b>World Total</b>	<b>616</b>	<b>894</b>	<b>1889</b>	<b>2938</b>	<b>5196</b>	<b>6314</b>
<b>Developed Countries</b>	<b>375</b>	<b>546</b>	<b>1380</b>	<b>2052</b>	<b>3354</b>	<b>4210</b>
EU	186	236	740	1131	1835	2376
US	83	185	395	536	966	1239
UK	63	64	204	200	368	483
Japan	3	5	10	34	46	54
<b>Developing Countries</b>	<b>241</b>	<b>347</b>	<b>488</b>	<b>849</b>	<b>1740</b>	<b>1979</b>
Africa	16	25	39	61	89	95
Latin America & the Caribbean	50	80	117	202	520	607
Argentina	5	7	9	28	62	73
Brazil	18	26	37	43	164	198
Mexico	8	19	22	41	78	91
South, East & S.E. Asia	175	213	297	535	1047	1184
China	6	11	25	137	306	347
Hong Kong	139	144	163	188	405	470
India	1	1	2	6	17	19
Korea, Republic of	1	2	5	9	32	42
Malaysia	5	7	10	29	49	54
Singapore	6	13	29	60	83	89
Taiwan Province of China	2	3	10	16	23	28
Thailand	1	2	8.2	17.5	21.7	24
<b>Least Developed Countries</b>	<b>3</b>	<b>5</b>	<b>8</b>	<b>17</b>	<b>31</b>	<b>35</b>

Source: World Investment Report, 2001

Table 2. **Stock of Inward Foreign Direct Investment: share of principal countries, 1980-2000**  
(percentage)

<b>Host Region / Economy</b>	<b>1980</b>	<b>1985</b>	<b>1990</b>	<b>1995</b>	<b>1999</b>	<b>2000</b>
<b>World Total</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>	<b>100</b>
<b>Developed Countries</b>	<b>60.9</b>	<b>61.1</b>	<b>73.1</b>	<b>69.8</b>	<b>64.5</b>	<b>66.7</b>
EU	30.1	26.4	39.2	38.5	35.3	37.6
US	13.5	20.6	20.9	18.2	18.6	19.6
UK	10.2	7.2	10.8	6.8	7.1	7.6
Japan	0.5	0.5	0.5	1.1	0.9	0.9
<b>Developing Countries</b>	<b>39.1</b>	<b>38.8</b>	<b>25.8</b>	<b>28.9</b>	<b>33.5</b>	<b>31.3</b>
Africa	2.6	2.8	2.1	2.1	1.7	1.5
Latin America & the Caribbean	8.1	8.9	6.2	6.9	10.0	9.6
Argentina	0.8	0.8	0.5	1.0	1.2	1.2
Brazil	2.8	2.9	2.0	1.4	3.2	3.1
Mexico	1.3	2.1	1.2	1.4	1.5	1.4
South, East & S.E. Asia	28.4	23.8	15.7	18.2	20.2	18.8
China	1.0	1.2	1.3	4.7	5.9	5.5
Hong Kong	22.6	16.1	8.6	6.4	7.8	7.4
India	0.2	0.1	0.1	0.2	0.3	0.3
Korea, Republic of	0.2	0.2	0.3	0.3	0.6	0.7
Malaysia	0.8	0.8	0.5	1.0	0.9	0.9
Singapore	1.0	1.5	1.5	2.0	1.6	1.4
Taiwan Province of China	0.4	0.3	0.5	0.5	0.4	0.4
Thailand	0.2	0.2	0.4	0.6	0.4	0.4
Least Developed Countries	0.5	0.6	0.4	0.6	0.6	0.6

Source: World Investment Report, 2001

Table 3. **Inward Stock of FDI as Percentage of Gross Fixed Capital Formation, 1989-1999**  
(percentage)

<b>Host Region / Economy</b>	<b>1989-1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>
<b>World Total</b>	<b>4.1</b>	<b>5.3</b>	<b>5.9</b>	<b>7.5</b>	<b>10.9</b>	<b>16.3</b>
<b>Developed Countries</b>	<b>3.7</b>	<b>4.4</b>	<b>4.8</b>	<b>6.1</b>	<b>10.6</b>	<b>17</b>
EU	5.4	6.7	6.5	8.1	15.7	27.7
US	4.8	5.3	7.0	7.9	11.3	17.9
<b>Developing Countries</b>	<b>5.2</b>	<b>7.7</b>	<b>9.1</b>	<b>10.9</b>	<b>11.7</b>	<b>13.8</b>
Africa	5.8	6.7	7.6	9.1	8.8	10.4
Latin America & the Caribbean	6.2	9.6	12.3	15.9	17.6	27.3
Argentina	8.6	12.1	14.1	16.1	12.2	47.7
Brazil	1.7	3.8	7.0	11.7	18.4	31.3
Mexico	10.1	20.6	16.7	17.7	13.2	11.7
South, East & S.E. Asia	5.9	8.2	9.1	10.1	10.4	11.2
China	7.9	14.7	14.3	14.6	12.9	11.3
Hong Kong	14.8	14.6	21.7	19.8	29.9	60.2
India	0.6	2.4	2.9	3.8	2.9	2.4
Korea, Republic of	0.8	1.0	1.2	1.7	5.7	9.3
Malaysia	19.4	15.0	17.0	15.1	13.9	20.1
Singapore	30.3	31.2	29.7	35.3	20.6	26.1
Taiwan Province of China	2.9	2.4	3.0	3.4	-	4.4
Thailand	5.0	2.9	3.0	7.2	20.7	13.7
<b>Least Developed Countries</b>	<b>5.7</b>	<b>5.2</b>	<b>5.4</b>	<b>5.9</b>	<b>6.2</b>	<b>7.9</b>

Source: World Investment Report, 2001

Table 4. **Stock of Inward FDI: share of principal developing countries**  
(percentage)

<b>Host Region / Economy</b>	<b>1980</b>	<b>1985</b>	<b>1990</b>	<b>1995</b>	<b>1999</b>	<b>2000</b>
Argentina	2.07	2.02	1.84	3.30	3.56	3.69
Brazil	7.26	7.41	7.60	5.01	9.43	9.99
Mexico	3.36	5.42	4.59	4.84	4.48	4.60
China	2.49	3.03	5.08	16.18	17.59	17.53
Hong Kong	57.68	41.50	33.40	22.14	23.28	23.75
Korea, Republic of	0.46	0.63	1.07	1.11	1.84	2.12
Malaysia	2.16	2.13	2.11	3.38	2.80	2.74
Singapore	2.57	3.75	5.86	7.02	4.77	4.50
<b>Total</b>	<b>78.00</b>	<b>66.00</b>	<b>62.00</b>	<b>63.00</b>	<b>68.00</b>	<b>69.00</b>

Source: World Investment Report, 2001

Table 5. **Inflows of FDI by Host Region/Economy**  
(US\$ billion)

<b>Host Region / Economy</b>	<b>1989-1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
<b>World Total</b>	<b>200</b>	<b>331</b>	<b>385</b>	<b>478</b>	<b>693</b>	<b>1075</b>	<b>1271</b>
<b>Developed Countries</b>	<b>137</b>	<b>203</b>	<b>220</b>	<b>271</b>	<b>483</b>	<b>830</b>	<b>1005</b>
E.U.	77	113	110	128	261	467	617
U.S.	43	59	84	103	174	295	281
U.K.	19	20	24	33	71	82	130
Japan	1	0	0	3	3	13	8
<b>Developing Countries</b>	<b>60</b>	<b>113</b>	<b>152</b>	<b>187</b>	<b>188</b>	<b>222</b>	<b>240</b>
Africa	4	5	6	7	8	9	8
Latin America & the Caribbean	18	32	51	71	83	110	86
Argentina	3	6	7	9	7	24	11
Brazil	1	5	10	19	29	31	34
Mexico	7	10	10	14	12	12	13
South, East & S.E. Asia	35	74	89	99	86	96	137
China	14	36	40	44	44	40	41
Hong Kong	4	6	10	11	15	25	64
India	0	2	3	4	3	2	2
Korea, Republic of	1	2	2	3	5	11	10
Malaysia	4	6	7	7	3	4	6
Singapore	5	9	10	13	6	7	6
Taiwan	1	2	2	2	0	3	5
Thailand	2	2	2	4	5	4	2
<b>Least Developed Countries</b>	<b>1</b>	<b>2</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>4</b>

Source: World Investment Report, 2001

Table 6. **Inflows of FDI by Region as a percentage of total world flows**  
(percentage)

<b>Host Region / Economy</b>	<b>1989-1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
<b>Developed Countries</b>	<b>68.5</b>	<b>61.5</b>	<b>57.1</b>	<b>56.8</b>	<b>69.8</b>	<b>77.2</b>	<b>79.1</b>
E.U.	38.3	34.3	28.5	26.7	37.7	43.5	48.6
U.S.	21.3	17.8	21.9	21.6	25.2	27.4	22.1
U.K.	9.6	6.0	6.3	7.0	10.2	7.7	10.3
Japan	0.5	0.0	0.1	0.7	0.5	1.2	0.6
<b>Developing Countries</b>	<b>29.8</b>	<b>34.2</b>	<b>39.6</b>	<b>39.2</b>	<b>27.2</b>	<b>20.7</b>	<b>18.9</b>
Africa	2.0	1.4	1.5	1.5	1.1	0.8	0.6
Latin America & the Caribbean	8.7	9.8	13.3	14.9	12.0	10.3	6.8
Argentina	1.3	1.7	1.8	1.9	1.1	2.2	0.9
Brazil	0.7	1.7	2.7	3.9	4.2	2.9	2.6
Mexico	3.3	2.9	2.6	2.9	1.7	1.1	1.0
South, East & S.E. Asia	17.5	22.2	23.2	20.6	12.4	9.0	10.8
China	7.0	10.8	10.4	9.3	6.3	3.8	3.2
Hong Kong	2.1	1.9	2.7	2.4	2.1	2.3	5.1
India	0.2	0.6	0.7	0.8	0.4	0.2	0.2
Korea, Republic of	0.4	0.5	0.6	0.6	0.8	1.0	0.8
Malaysia	2.0	1.8	1.9	1.4	0.4	0.3	0.4
Singapore	2.4	2.7	2.7	2.7	0.9	0.7	0.5
Taiwan	0.6	0.5	0.5	0.5	0.0	0.3	0.4
Thailand	1.0	0.6	0.6	0.8	0.7	0.3	0.2
<b>Least Developed Countries</b>	<b>0.7</b>	<b>0.6</b>	<b>0.6</b>	<b>0.6</b>	<b>0.5</b>	<b>0.5</b>	<b>0.3</b>

Source: World Investment Report, 2001

Table 7. **Inflows to largest developing country recipients as a proportion of total flows to developing countries**  
(percentage)

<b>Host Region/Economy</b>	<b>1989-1994</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
Argentina	4.52	4.95	4.56	4.89	3.87	10.88	4.64
Brazil	2.51	4.83	6.88	10.00	15.31	14.13	13.97
Mexico	11.03	8.40	6.49	7.39	6.16	5.37	5.48
China	23.42	31.63	26.35	23.61	23.23	18.16	16.98
Hong Kong	6.99	5.48	6.86	6.07	7.84	11.08	26.83
Korea, Republic of	1.46	1.57	1.52	1.52	2.87	4.77	4.24
Malaysia	6.65	5.13	4.78	3.48	1.43	1.59	2.31
Singapore	8.05	7.75	6.80	6.92	3.35	3.24	2.66
<b>Total</b>	<b>65.00</b>	<b>70.00</b>	<b>64.00</b>	<b>64.00</b>	<b>64.00</b>	<b>69.00</b>	<b>77.00</b>

Source: World Investment Report, 2001

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