Transnational Corporations Review Volume 7 Number 2 June 2015
www.tnc-online.net info@tnc-online.net 125-127

Attracting Foreign Direct Investment and Benefiting from it: Challenges for the Least Developed Countries

Karl P. Sauvant

All the least developed countries (LDCs) need to attract foreign direct investment (FDI) and benefit from it as much as possible in order to advance their development.

In fact, LDCs as a group are not doing that badly in terms of FDI inflows. The US$25 billion they attracted on average during 2011-2013 constituted about 2% of world FDI flows. But these US$25 billion amounted to about 13% of these countries' gross fixed capital formation. And that is a higher percentage than for any other country group. In other words, the FDI that LDCs received is more important for them than the FDI that other country groups received – although it is quite unevenly distributed among LDCs.

And while it is also true that most FDI in LDCs is in natural resources, an increasing share goes into manufacturing and services. Transnational corporations (TNCs) from all parts of the world, including those headquartered in such rising emerging markets as China, India, Malaysia, and South Africa, invest in the continent. Interestingly, outward FDI from African LDCs is rising as well, having reached US$4 billion last year. This indicates that some firms in a number of these countries have reached the international competitiveness that is needed to flourish in the world FDI market.

These are encouraging trends. The international community needs to support them, precisely because FDI can make an important contribution to economic growth and development. The challenge is twofold: to help **increase FDI flows** to LDCs; and to **increase the contribution** that the FDI flows that LDCs receive make to the development of host economies.

To turn to the first challenge: as we know, FDI is undertaken by private firms (although state-owned enterprises are also becoming important) that have the capabilities to compete abroad and find it advantageous to do so through international production. Understanding *where* their FDI flows are directed requires that we look at the locational determinants of FDI. Three sets of determinants at the host-country end are particularly important: the economic determinants; the regulatory framework; and FDI promotion.

The most important factor for enterprises to undertake FDI in a country is the nature of the *economic determinants*: quality of infrastructure, size of the market, growth of the market, availability of skills, technological infrastructure, etc. If the economic determinants are not favourable for firms to make a profit, FDI will not take place. To put it differently: while the economic determinants are not everything, everything is nothing if the economic determinants in a potential host country are not favourable. The economic determinants are the key for attracting FDI. As we know, however, the economic determinants in LDCs are not favourable. They need to be strengthened, and official development assistance (ODA) is critical for that purpose.

Naturally, FDI can only take place when the *regulatory framework* is enabling. There is no doubt that LDCs have made considerable efforts to improve this framework at both the national and international levels. But, of course, more can – and should – be done to make the enabling framework more welcoming. Let me mention only one practical example: individual LDCs could appoint Investment Ombudspersons, i.e., persons who have the confidence of the government and of the business community in a given country and, in this manner, could resolve conflicts in an informal manner before they escalate into disputes that are costly and disruptive for all. The Republic of Korea has had positive experiences with such an institution. But, by and large, however – and this needs to be emphasized -- the regulatory framework for FDI is quite welcoming in LDCs. They are open for business. In fact, the FDI regulatory frameworks of LDCs are quite similar to those of other developing countries.

The third set of FDI determinants, finally, concerns *investment promotion*. Precisely because the FDI regulatory frameworks are quite similar across the developing world, investment promotion plays a particularly important role, and especially for LDCs. This is even more so because the economic determinants are typically better in the non-LDCs. But Investment promotion agencies (IPAs) in LDCs are typically weak. They often do not have the capacity to target investors and follow-up with them once they have established themselves in a host country. After-investment services are particularly important: satisfied foreign affiliates in a host country are the country's best ambassadors to encourage the reinvestment of earnings and bring in more FDI. Investment advisors who would work on a day-to-day basis with investors could be helpful. In short, IPAs need strengthening, and ODA could play a role here.

Therefore, the key for LDCs to obtain more FDI is to strengthen these three sets of FDI determinants.

Obtaining more FDI is one challenge, *increasing the benefits* of the FDI that LDCs obtain is the second challenge. After all, countries do not attract FDI just for the sake of attracting it. They attract FDI to help as much as possible in their growth and development. This is a challenge often somewhat neglected. Two examples show how benefits can be increased.

The single most important mechanism to transfer the tangible and intangible assets and capabilities of foreign affiliates to domestic firms is through the mechanism of *linkages*, e.g., domestic firms becoming suppliers of foreign affiliates and, ideally, part of their global supply chains (GVCs). Governments can institute linkage programmes in order to upgrade potential suppliers. Singapore is one of the countries done this successfully.

TNCs themselves can play a key role in that context by deliberately looking for firms in their host countries that could provide inputs at the right price and quality. They may need to overcome inertia to do that, but they can benefit from linkages as well, as sourcing locally reduces the vulnerability of their GVCs. In other words, linkages are often in the own interest of TNCs, and governments can encourage the linkage-building process through various means.

Home countries, too, can do various things to enhance the contribution of their TNCs to the economic growth and development of LDCs. In particular, they can link the support they give to their firms investing abroad to certain conditions relating to the impact those firms have on their host countries. And a number of home countries do precisely that. For example, the Overseas Private Investment Corporation of the United States makes it a requirement that the project it supports adheres to certain workers' rights enshrined in International Labour Organization (ILO) Conventions. The Japan Bank for International Cooperation requires that environmental impact studies are undertaken before it supports FDI projects. The European Union has a similar requirement. Such home-country measures enhance the positive impact of FDI in host countries.[1]

Another example of how host countries can improve the benefits they derive from incoming FDI involves *negotiating better contracts* with TNCs and other investors. This is particularly important in natural resources (and, as pointed out before, most FDI in LDCs is in natural resources), but it is also relevant for various infrastructure and other projects. Fair contracts are of key importance for host countries, as they determine the distribution of benefits associated with the projects involved for years to come. And well-negotiated contracts with TNCs and other participants for implementing large-scale complex projects make an important contribution to the self-financed graduation of LDCs from their LDC status.

Moreover, well negotiated large-scale, complex contracts between LDCs and TNCs can reduce the incidence of conflicts between host countries and TNCs, conflicts that are disruptive for both of them and, if they go to international arbitration, can be very expensive. In fact, between 1972 and mid-2014, some 30 percent of all cases before the International Centre for Settlement of Investment Disputes (ICSID) were linked to natural resources. If one adds infrastructure, an additional 30 percent of all international arbitrations are accounted for. Unfortunately, though, LDCs typically do not have the multidisciplinary capacity required to arrive at the best possible contracts when negotiating with TNCs – they simply do not have the world-class negotiating teams required for that purpose. It is therefore very encouraging that the G7 is considering helping developing countries in this regard, and that LDCs supported this in their Cotonou agenda.[2]

The examples show a number of ways how LDCs can seek to obtain higher FDI inflows and how to benefit more from them. It may be appropriate for the international community to launch, through the United Nations, an action plan for FDI in LDCs, a plan that can be based on the coordination of various efforts already underway and enhance a number of them. Implementing such a plan can make tremendous contributions in helping LDCs to *attract* more FDI and *benefit* more from it.

About the Author

Dr. Karl P. Sauvant is Resident Senior Fellow, Columbia Center on Sustainable Investment, a joint center of Columbia Law School and The Earth Institute at Columbia University, New York. He was the Founding Executive Director of the predecessor of that Center, the Vale Columbia Center on Sustainable International Investment, and UNCTAD's Investment Division. This note is based on a presentation given by the author to the United Nations Second Committee on November 24, 2014.

Contact Information

The author can be contacted through email: karlsauvant@gmail.com.

[1] For a full discussion of the various ways in which home countries support the outward FDI of their firms, see Karl P. Sauvant, Persephone Economou, Ksenia Gal, Shawn Lim, and Witold P. Wilinski, "Trends in FDI, home country measures and competitive neutrality", in Andrea K. Bjorklund, ed., *Yearbook on International Investment Law & Policy 2012-2013* (New York: Oxford University Press, 2014), ch. 1.

[2] See in this context also www.negotiationsupport.org, a portal established by the Columbia Center on Sustainable Investment to assist in the negotiation of contracts.