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International Direct Investment and the new
economic environment

The Tokyo Round Table
OECD/OCDE, Paris 1989

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INTERNATIONAL DIRECT INVESTMENT AND THE NEW ECONOMIC ENVIRONMENT



OCDE



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PARIS 1989

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- to contribute to the expansion of world trade on a multilateral, non-discriminatory basis in accordance with international obligations.

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After a brief lull in the early 1980s, international direct investment in the OECD area is again displaying strong growth and contributing to the greater world economic integration and interdependence that has been particularly evident in recent years. Reflecting the growing internationalisation and globalisation of business strategies, the flow of investment between OECD countries is now much more balanced, with more countries active as both host as well as home countries. International direct investment is, therefore, making a contribution to growth, employment, technology transfer and structural adjustment on a much broader geographical basis and this, too, is reflected in an increasingly open and liberal treatment of inward investment by host governments.

The situation in the developing countries contrasts sharply with that in the OECD area during a time when increased direct investment would have been particularly desirable; there has been a marked reversal since 1981 in the developing countries' ability to attract such investment. Previous to that date, they were receiving a growing share of direct investment flows, but these have since declined in both absolute and relative terms, and current levels of inflows have still not caught up with the 1981 peak of \$17 billion. The situation has been further complicated by the sharp fall in bank lending which, four times the level of direct investment at the beginning of the eighties, is now about half the current level of investment inflows. In addition, there has been an important shift in investment patterns towards Asia, particularly the newly industrialised economies of South East Asia, at the expense of Latin America.

In response to these developments, the OECD's Committee on International Investment and Multinational Enterprises (CIME) has devoted increasing efforts to analysing the forces behind these events and to examining ways and means to increase the flow of international direct investment to developing countries and its contribution to development. One of the elements of the CIME's approach has been to organise Round Table meetings with the parties directly involved in investing in developing countries. These meetings have the aim of stimulating an open and pragmatic exchange of ideas which should lead to greater mutual understanding and practical actions to improve the situation.

Following a very positive experience with the first International Round Table on Foreign Direct Investment and Development, held in West Berlin in May 1986, the second International Round Table on International Direct Investment and the New Economic Environment, hosted by the Export-Import Bank of Japan in co-operation with the Ministry of Foreign Affairs, the Japanese Federation of Economic Organisations and the OECD's CIME, was held in Tokyo in February 1989. The Japanese government is to be congratulated for the very considerable efforts they devoted to the selection of participants from developing countries. The Export-Import Bank of Japan must be equally congratulated for its organisational efforts and the excellent facilities made available.

The Round Table focused on three key elements in the present position of the developing countries with respect to international direct investment; the general policy environment for direct investment (taken up in the discussion of trends in direct investment in chapter I), and the role and implications of debt problems and new technology on direct investment and its contribution to development (chapters II and III respectively).

The Tokyo Round Table provided an effective setting for a frank, informal and problem-oriented exchange of views on the ability of developing countries to attract international direct investment, the difficulties they currently face in this respect and ways and means by which this situation could be improved. In this sense, the Round Table was successful with respect to the aims set for it.

The debate was generally constructive and non-ideological, with attention devoted less to how particular difficulties or problems had arisen and more so to what could be done to improve the situation. It was particularly noticeable that these discussions looked at the role that each of the various parties could play (host and home governments, business, international organisations) rather than what one group of participants felt another group should be doing.

The discussions showed that there is now, indeed, a lot of common ground between the various parties involved in international direct investment in developing countries, with all demonstrating both an interest and a desire to improve the flow of international direct investment to these countries. The convergence of views reflected in the summaries by the session Chairmen constitutes an important movement in attitudes which, although already apparent at the 1986 Berlin Round Table, was much more pronounced in Tokyo.

A general concern of participants was that, while there has been some recent growth in international direct investment flows to the developing countries, most of these had still not caught up with the levels they attained at the beginning of the decade. Participants from some developing countries indicated a certain disappointment given the efforts that many have undertaken or are in the process of undertaking to liberalise their laws, regulations and practices concerning international direct investment, and indeed private investment in general, while others felt that the efforts they had made had not been matched by efforts of some enterprises to make better use of local resources or to integrate more fully with the local economy. Nevertheless, an encouraging feature of the Round Table was that developing country participants took a positive approach to international direct investment and no participant suggested a return to previous more restrictive policies. In fact, even if there were differences of views on specific problems and practical approaches for resolving them, all participants emphasised the need to pursue and develop present, more liberal approaches as the most appropriate means of increasing the attractiveness of their economies to international direct investment.

The proceedings of the Tokyo Round Table are published under the responsibility of the Secretary-General as a contribution of the OECD's CIME to the ongoing engaged dialogue between Member countries on foreign direct investment.

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WELCOMING ADDRESS

by
Mr. T. Tanaka,
President, Export-Import Bank of Japan

This Round Table, like its predecessor in West Berlin in 1986, brings together those who play a leading role in promoting international direct investment. It is with great pleasure, therefore, that I welcome here in Tokyo, on behalf of the organiser, participants from governments, the private sector and labour organisations from both the OECD Member countries and the developing countries, as well as international organisations active in promoting worldwide economic development.

I would, in particular, like to express my appreciation that Mr. Makino, Deputy Parliamentary Minister of Foreign Affairs, has been able to join us on behalf of the Minister, Mr. Uno. I would also like to take this opportunity to thank the OECD, the Ministry of Foreign Affairs and the Japanese Federation of Economic Organisations who have co-operated with the Export-Import Bank of Japan in organising this Round Table.

I believe that the present time is a most opportune one to meet to exchange views, to deepen mutual understanding and to address in a positive manner the key issues surrounding foreign direct investment and its promotion in developing countries. Foreign investment programmes, particularly the flow of funds from the private sector, are recognised for the important contribution they can make to the development programmes of developing countries. This is particularly so in light of the major challenges presently facing the world economy – both for developed as well as developing countries and their respective regional economies – and the need to achieve balanced and sustainable growth in the years ahead.

Since 1985, Japan's currency, the yen, has appreciated rapidly and Japanese industries have gone overseas and become much more involved in the international economy. This is seen in the rapid growth of Japanese investment abroad, which rose to \$33 billion in 1987 and \$47 billion in 1988, a rapid growth indeed! Approximately 30 per cent of this overseas investment goes to the developing world, particularly to the manufacturing sector of the Asian economies. These investments have played an important role in promoting structural adjustment in the Japanese economy and, we hope, have made a significant contribution to economic growth in the developing countries. The Export-Import Bank of Japan is actively supporting these investments through its financial operations.

The Export-Import Bank established the Research Institute of Overseas Investment in 1974, which undertakes surveys and research related to international investment and economic development in developing countries. We are therefore pleased to have been able to organise and sponsor this Round Table.

Over the next three days, we shall be discussing recent trends in foreign direct investment and the impact of indebtedness and new technologies on direct investment in the developing countries. Each of these themes is important in its own light and I hope that the participants of this Round Table will all benefit from an enlightened discussion of these

topics. It will clearly be an achievement if the results of these discussions can give new insights and perspectives as well as some guidelines to those involved in the process of investment in the developing countries – governments, the private sector, labour and the international organisations.

OPENING REMARKS TO THE ROUND TABLE

1. Mr. Sosuke Uno, Minister of Foreign Affairs, Japan

Foreign direct investment, the primary focus of this Round Table, is expected to exceed \$1 trillion worldwide in 1988. The influence of this vast sum on the global economy cannot be overemphasized.

Since the beginning of this decade, foreign direct investment has expanded steadily, particularly among the industrialized nations. Its growth has been encouraged in several ways. For one, the free flow of investment has been promoted in line with the OECD Code of Liberalisation of Capital Movements. Market deregulation and privatisation measures have also been major contributing factors. As a result, such investments have played a leading role in realising sustained growth and streamlining the world economy. In full appreciation of this role, it is crucial that OECD Member countries endeavour to remove remaining obstacles to progress in opening markets to even greater direct investment from abroad. At the same time, it is equally evident that much work needs to be done to put a halt to the protectionist movements which have been gaining ground in recent years.

The decade has not, however, been as kind to the developing countries. Prices for primary products, a mainstay source of capital to fuel their economies, plummeted at the start of the global recession, seriously exacerbating the recession at home, and thus the debt crisis. These developments in turn served to cut off the flow of investment so vital to their continued growth. Indeed in 1987, total debt accumulation for the developing countries was \$1 300 billion. And, to make matters even worse, current efforts by debtor nations to stimulate the growth of, and confidence in, their economies seem to be having difficulties in even getting off the ground. Obviously, they will have to implement more aggressive adjustment measures than attempted thus far. Yet, as has been emphasized before, the industrialised nations can more effectively stimulate developing economies by sustaining non-inflationary global economic growth, improving the trade environment and boosting the international flow of capital. The advanced nations are being urged to take effective and suitable actions to help ease their plight, as called for in the communiqué issued after the meeting of the OECD Council at Ministerial level in 1987. Needless to say, the global economy cannot achieve and sustain balanced growth while ignoring the economies of the developing world.

These conditions underscore the timeliness of calls by the OECD Committee on International Investment and Multinational Enterprises for a multifaceted professional dialogue on the issue of foreign direct investment. Such investment is not debt creating, and it offers developing nations a variety of desired economic and social benefits, be they in higher production, technological transfers, or opportunities for employment. Yet, to enjoy fully these and other benefits, they must first cultivate an environment conducive to foreign direct investment and revamp the existing institutional framework.

The first half of the 1980s saw much lethargy in the flow of investment to developing nations, a trend that ended in 1986 with an annual jump of 45 per cent worldwide. This

increase was primarily due to new foreign direct investment in the newly industrialising economies of Asia. Given the limited demand of their relatively modest domestic economies, these economies had early on adopted strategies of industrialisation geared towards the production of exports, strategies which at the same time welcomed the inflow of foreign capital. By thus securing needed funds and advanced technologies to build a basic industrial infrastructure, these economies then drew on their good quality labour force to achieve high levels of productivity and economic betterment. This receptive approach to foreign direct investment has been particularly pronounced in the ASEAN member states. Now it is also becoming more apparent to the Central and South American nations that seek relief from their heavy debt burdens. Indeed, this approach holds great promise as a viable stimulus to future economic growth.

This second Round Table comes in the midst of such events. And Japan, as its host, is especially interested in the course of the dialogue that will transpire, particularly concerning viable new investment environments for the world's developing regions. The Round Table should have a truly rich and meaningful discussion on a host of issues : topics for consideration include the new debt equity swap approach to lighten debt burdens and other new approaches such as co-financing, involving international financial institutions. Complementary discussions will take up the spread of new technologies, including those in the information field, and recent developments concerning technological transfers and the protection of intellectual property rights. Certainly at question will be the contribution of these and other means, and what both the industrialised and developing nations must do to encourage greater foreign direct investment. The discussions should also give ample consideration to the initiatives that international financial institutions can take to catalyze capital flows to developing nations.

The global economy is today characterised by ever-strengthening bonds of mutual interdependence. If balanced growth is to be achieved in the years ahead, then it is absolutely essential that we co-operate together to find international solutions for the problems it now faces, particularly regarding ways to stimulate the flow of investment capital to the developing nations. The Round Table, in stimulating an open and pragmatic exchange of ideas, will help pave the way for future action.

2. Mr. Robert A. Cornell, Deputy Secretary-General, OECD

A review of recent trends in direct investment itself as well as government policies towards direct investment reveals much to be congratulated but also some areas of growing concern.

Let us view the good news first. There is no question that direct investment is growing, and that it's growing at a fairly rapid pace. Investment by firms headquartered in the OECD countries has really taken off again during the last few years, following a fairly weak performance in the early 1980s. This growth reflects, on the one hand, recovery in the world economy and, on the other hand, the relentless institutional and technological changes that have made an interdependent world market a fact of life.

Total outward direct investment flows from the major OECD countries rose from some \$59 billion in 1985 to \$92 billion in 1986, an increase of about 57 per cent. In 1987, direct investment from the same countries surged ahead another 42 per cent to \$131.4 billion. In the case of the United States, the increase in the outward direct investment position jumped to \$49.2 billion. Strong growth in outward direct investment was also registered in 1987 by Japan, up 34 per cent, the United Kingdom, up 51 per cent, the Netherlands, up 34 per cent and France, up 56 per cent.

1986 and 1987 also saw what at first sight might appear to be a resurgence of the flow of direct investment to developing countries. The inflow to developing countries for each of these years averaged \$12.7 billion, roughly double the amount for 1985, and recovering the 1982 through 1984 levels. The increase came from sharply higher levels of direct investment by the United States and Japan, both of which have doubled since 1985.

A closer look at the United States data shows, however, that the 1987 results did not really represent a significant recovery of United States investor interest in most of the developing countries. Over half of the increase in 1987 went to Bermuda and the Netherlands Antilles, and reflected essentially intra-company financial transactions. Hong Kong played much the same role for United States investors in Asia. In Africa, most of the investment went into Nigeria's petroleum sector. Japanese firms' investment in developing countries was about equally spread between Asia and Latin America, with their Asian investment mainly going to the manufacturing sector. Over 90 per cent of their investments in Latin America were in offshore banking centres and in Panama's flag of convenience shipping business.

Thus, aside from the more dynamic Asian countries, very few developing countries experienced a significant increase in foreign direct investment in manufacturing. What has actually been happening to direct investment in developing countries presents, therefore, a less optimistic picture. Indeed, the main conclusion to be drawn from analysing investment flows in the last few years is that the surge of outward direct investment from the OECD countries is, in fact, a surging back and forth of investment by these countries in each other.

Turning to direct investment policies, there is again good news, but it tends to be offset by other recent developments. One can see a quite clear trend, both in the industrialised countries and in a number of developing countries in various regions of the world towards a liberalising of investment policies, liberalising in the sense of relaxing controls, relaxing screening requirements and abandoning some, though in many cases not all, performance requirements as instruments of policy. A country by country examination of the situation would be necessary to get the full flavour of these developments, but the broad pattern nevertheless is quite evident.

Among the industrialised countries, the reason for this progress lies to an important extent in a recognition that they play a dual role as both home and host countries to direct investment, especially given the recent surge of investment among countries in the OECD area noted above. As a result, their policies are tending towards a more balanced approach that recognises their function as both the providers and the recipients of direct investment capital.

Among developing countries, motivations differ. Some disenchantment can be detected with the policy rationales that were provided during the 1970s and early 1980s for the more restrictive regimes. This is, of course, not the case for every country; equally, not everyone would subscribe to that view. In addition, a certain element of force majeure has intervened, whatever the policy views that governments may have. Countries which bear severe debt burdens may have felt in some cases almost pushed rather than led into relaxation of policies which discourage direct investment.

Against this background of what seems to be a general trend towards liberalisation, some developments in the opposite direction also have appeared, and here, unfortunately, the most significant signs of actual or potential investment protectionism paradoxically occur within the industrialised countries themselves. In the United States, an intense political debate has developed. In the early versions of the now adopted United States Trade Bill, some provisions would have moved the United States definitively back from its two centuries old policy of having a very open investment climate. Generally speaking, the

Administration was able to defeat those proposals, but that doesn't mean that the debate is over. In fact, the same proposals are back on the table in Congress and one can expect that the debate will go on for some time. There is thus a risk that the open investment climate of the United States may start to close in coming years.

Though less highly politicised, similar tendencies may be developing in Western Europe. For example, the use of local content requirements has become considerably more common in some European countries and is giving rise to important political frictions. It is not yet clear whether these, as yet relatively isolated, developments will take form and become a definite trend. What is clear is that they need to be watched, taken into account, and discussed in any meeting of this type.

The present situation therefore reveals direct investment flows increasing but perhaps not in the directions that are the best for stimulating rapid growth and rapid development, especially in the developing world. At the same time, we see conflicting trends or conflicting developments on the policy side with respect to direct investment. Given this background, the Round Table could consider the issues arising from these trends by addressing the following questions.

First, and in order to provide a basis for the discussion, is there agreement on the facts about what is actually happening? Second, is there agreement on the economic rationale behind the facts and the trends observed? Third, is there agreement on the policy reasons behind these events? Here, there are clearly both economic as well as political forces at play, the two sometimes together, sometimes at odds with each other. Fourth, and on the basis of the above, is there agreement on how to shape trends in the service of faster development and sounder economic growth, especially in the Third World?

The objective of this Round Table is to facilitate a dialogue between the parties involved in international direct investment and development. In permitting an airing of the argument, especially concerning policy, the Round Table should aim to establish a common ground and, in so doing, develop a broader consensus as to the way ahead.

3. Mr. Adriaan Gautier, Chairman of the OECD Committee on International Investment and Multinational Enterprises

A casual glance at the treatment of foreign direct investment in the economic press may well give the reader the impression that this specific economic activity has that rare feature of bringing major benefits, with no or only few associated costs.

In that context it is easy to understand that, whenever statistics show that a specific section of the globe is not receiving its appropriate share of that investment, there is every reason for concern. It is then only logical that there is a call for an enquiry into the nature and causes of that misfortune and that being done, numerous sources are eager to advise as to how the situation should be redressed. Such advice invariably centres on the vague, but no doubt well-meant contribution that "the investment climate should be improved".

And if there is an initial reluctance to follow immediately each and every piece of advice so offered, an extensive enumeration generally follows to remind the reluctant party of the advantages that will be foregone. Such enumerations never fail to include the inflow of (interest free) foreign capital, the transfer of advanced and sophisticated technology and management practices, all of which are pointed out as essential contributions to economic growth.

Of course, there are obvious pitfalls in such a simplification of the issues surrounding foreign direct investment in the developing countries. I am only too well aware of the

attitudes towards foreign direct investment that were prevalent in the early seventies, and the reluctance to accept multinational enterprises as partners in the process of development. Whatever views one holds on the past, there must be scope for an understanding of that reluctance. There is also ample evidence that, in general, this reluctance, by now, is something of the past. The mere fact that we meet here in this Round Table to discuss foreign direct investment suggests that we are aware that, overall, it can have a clearly positive impact on economies and that it is worthwhile to find the ways and means best suited to accomplish this.

This awareness, however, does not imply a willingness to accept lock, stock and barrel each and every suggestion that is offered, because of different values and different perceptions of what is in the interest of countries still in the process of development, and sometimes also – the past is not all that easily forgotten – because of a distrust of the motives of those too eager to offer advice.

This Round Table will discuss foreign direct investment in the developing countries. Its organisers noted the continuance of the decline in investment flows to many parts of the developing world at a time when, in fact, such investment is most needed. The OECD Committee on International Investment and Multinational Enterprises has discussed this trend. It was felt that opportunities have been foregone from which all parties could have benefited. And, equally important, it is felt that, in light of the changes in perceptions of and attitudes to foreign direct investment I mentioned above, the present time is a most appropriate one for developing the dialogue between all those involved in how best to stimulate higher flows of investment to developing countries.

The OECD – one of the organisers of this Round Table – is clearly concerned with the impact of foreign direct investment on developing countries. The industrialised countries do have an interest in economic growth in that section of the world, which now absorbs a considerable share of their exports and has the potential to become the world's most dynamic market. There is also a sense of solidarity that has been reflected in the transfer of development aid. Foreign direct investment also provides OECD countries with an opportunity to demonstrate that they are aware of their responsibilities. The dialogue on global investment issues in which the OECD is involved demonstrates that this Organisation is an outward looking body, aware of its responsibilities towards the world at large. Although the OECD has already for many years kept an eye on the world outside its membership, this attitude has recently been intensified in an effort to strengthen the links with non-Members.

The time and energy invested in this meeting by our co-sponsors, the Export-Import Bank of Japan, equally illustrates the awareness of the global responsibility that goes with the prominent place Japan has achieved in the ranks of industrialised nations.

By now, you should have an idea of the kind of dialogue that this Round Table meeting aims to promote. It should be a dialogue in which we take it for granted that host countries, in shaping their investment policies, have been guided by rational arguments based on the position of their countries as they perceive it. It should also be a dialogue in which, from the outset, we respect differences in the appreciation of traditional values and the concept of national sovereignty. For example, one topic on which we might concentrate concerns differing views and possible misconceptions about the impact of various policy options.

Another important topic related to foreign direct investment issues is the absence of an institutional framework of rules and procedures. In that context it has to be pointed out how well the draft UN Code on Transnational Corporations (in which attempts are made to link its provision with those of UNCTAD and the ILO) and the Multilateral Investment Guarantee Agency (MIGA) might complement each other. Those combined instruments could be seen as the nucleus of a future multilateral framework for investment. The next

few years may bring greater pressures to intensify efforts to achieve mutually acceptable rules of the game in the investment area. Such ground rules would provide a competent referee with adequate authority to blow the whistle with some effect, whenever a country is envisaging or embarking on a particular practice or policy that would upset the hard-won progress that is being achieved.

The job before this Round Table is a crucial one, because our dialogue deals with more than just an analysis of statistics and trends, or the theoretical merits of the one or the other government measure. When all is said and done, we are dealing with some essential factors of economic growth in each of our countries; and consequently – as far as economic growth can contribute to that – our common future.

SUMMARY OF THE ROUND TABLE DISCUSSION

Participants to the Round Table, who came from OECD and developing countries, and from government, business, labour and international organisations, confirmed the importance of the issues addressed – host and home country policies, the debt situation and the opportunities and challenges posed by technological developments. They also were able to establish areas of common ground as to the way ahead and the practical steps that could be taken by all involved to increase the contribution of direct investment to development. The remainder of this section provides some comments on the discussion of the three areas on which the Round Table focused.

International Direct Investment : Trends and Policies

The discussion of trends in international direct investment and the forces underlying recent patterns revealed a broad agreement on the part of participants on the need to improve the climate for inward direct investment in developing countries. The contribution of international direct investment to development is now much more widely accepted and it was remarked that reluctance to accept multinational enterprises as partners in the development process was now largely a thing of the past. The fact that participants from home and host countries as well as from business were willing to sit at the same table and discuss trends, strategies and difficulties linked to international direct investment was seen as a sign of greater awareness and involvement with such issues.

Participants focused more on the reasons underlying recent trends in international direct investment, but one or two did comment on these patterns. It was seen with some concern that most of the recent growth in international direct investment has taken place within the OECD countries, and that once account is taken of the flows to the newly industrialised economies (NIEs) of South East Asia and to offshore banking centres, the actual amount of international direct investment going into production, and particularly, manufacturing investment in Latin America, Africa and other parts of Asia was quite disappointing.

Participants from many of the developing countries outlined the types of changes that have been or are being undertaken in their countries where there is a fairly broad move towards greater openness and liberalisation for private investment in general, including international direct investment. For example, participants from some of the NIEs recalled the clear benefits their liberal approaches have yielded. Some other participants pointed out that while they are adopting a more welcoming attitude to foreign investment, changes in policies have not yet been matched by any clear trend to higher direct investment inflows. These participants stated that home countries and international organisations, in suggesting what developing countries could be doing, should take more into account not only the economic problems of developing countries but also the social and political pressures which

limit the speed by which more liberal investment regimes can be introduced, particularly when they are not seen to result in any immediate and significant improvements.

For example, the protection of infant industries from full international competition is still an important concern for some developing countries, as it is feared by some that uncontrolled entry of foreign investment would hinder the development of domestic enterprises. It was argued that restrictions on international direct investment or preconditions and performance requirements should also be seen from the perspective of stimulating the competitive development of the domestic sector and not just that of protecting it from foreign competition. Participants from different developing countries outlined their experiences in this respect. In some countries, particular sectors are still closed to foreign investment or subject to strict limitations; others have moved away from such a situation as previous approaches have not yielded the desired results.

Some developing country participants indicated that their experience with international direct investment has not always been positive. One example given concerned the net outflow of capital associated with international direct investment after the initial capital inflow. This was felt to place economic and political pressures on some countries, frequently leading to the use of trade-related measures such as local content or export requirements or of limitations on repatriations. Some of these participants commented that one of the areas where important progress could be made would be the development of stronger links between multinational and domestic enterprises. Stronger integration of the activities of multinational enterprises with the domestic sector would not only improve the host country perception of international direct investment but this would, in helping the development of the local sector, also contribute in other areas such as promoting the return of flight capital and facilitating necessary structural adjustment.

Some of the participants from business suggested that problems with developing links with local enterprises often stemmed from the lack of local partners with sufficient expertise to provide necessary inputs on a competitive basis. More generally, a number of business participants emphasised the importance they attach to viable, long-term investments in developing countries. A sound commercial basis and stable economic policies were seen by a number of these participants as the key factors; investment incentives have often little effect on longer term viability, but frequent changes in policies and stringent performance requirements could easily undermine the viability of projects and affect the commitment of the foreign investor to the host country.

A number of participants from the OECD area spoke of the progress made in their countries towards liberalisation and that, while there are presently a number of developments of some concern counter to this general trend, efforts are being made at the national and international levels to resist protectionist pressures and strengthen commitments to an open international economy. Some of these participants also welcomed the progress made in a number of developing countries towards the removal or relaxation of impediments to international direct investment and urged them to continue with such efforts.

Commenting on the outlook, some participants felt that the attraction of developing countries to international direct investment was again improving. There are clearly still many areas of difficulty covering, for example, particular measures or the general policy stance of some developing countries, the perception and attitudes of host countries to the activities of multinational enterprises and the contribution that home countries could make, but there was also a general sense that progress had been made and that it provided a good basis for further efforts by all concerned. Participants welcomed the opportunity, in particular, to discuss issues related to debt and technology, which they felt to be key factors influencing future trends in international direct investment to developing countries.

Debt

Participants were in broad agreement that high external indebtedness posed various difficulties to foreign investors and that progress in reducing debt burdens would be required before a significant resumption of international direct investment could be expected. At the same time, it was also generally felt that international direct investment could make important contributions to alleviating debt problems through not only the immediate capital inflow associated with investments, but also its longer-term effects through technology transfer, managerial and marketing practices, trade patterns and their contribution to competitiveness, exports and structural adjustment. Participants felt that the interdependence between debt and international direct investment emphasised the need for simultaneous efforts to reduce debt and increase investment and therefore for actions by all the parties involved – debtors, creditors and investors – rather than by any one group alone.

There were some differences in views as to the overall contribution to the alleviation of debt problems that international direct investment can make, but all participants did feel that it had some contribution to make and that efforts should be pursued with this goal in mind. Clearly, higher international direct investment is only one of a variety of factors necessary to achieve a significant improvement in the situation, but a number of participants stated that on the basis of their experience, it is much more preferable to induce international direct investment than bank loans.

Participants were all of the view that there are no quick and painless ways of resolving the debt problem. All of those involved need therefore to take a longer-term view and explore various approaches. A point emphasised by a number of participants was the need to restore the confidence of investors (both domestic and foreign) in developing countries. For example, some participants stated that progress in attracting the return of flight capital would be an important sign of greater confidence of local investors on which could be built efforts to attract international direct investment.

It was felt that major efforts should be devoted to debt reduction and orderly management of rescheduling. Some participants felt that important factors in this approach would be the assurance of access to OECD markets and changes in domestic policies. Greater access to OECD markets was mentioned by a number of participants from business and from developing countries as essential if exports were to be expanded to gain much needed foreign currency. The same participants felt, however, that the industrialised countries should not expect developing countries to open up their markets to the same extent or at the same speed until they are able to put their domestic sectors on a sounder and more stable footing and until they are in a stronger position to face greater market liberalisation. However, there seemed to be little disagreement on market liberalisation as a longer-term objective.

On the domestic policy front, encouragement of entrepreneurship and private investment was singled out by some participants. Privatisation was indicated as an area where an important contribution could be expected; it would encourage private investors, domestic as well as foreign, and contribute to structural adjustment efforts. At the same time it would result in important savings, given the very high appetite for capital of public enterprises. A number of developing country participants outlined their present experience with privatisation schemes. It was noted that while such schemes were expected to make an important contribution, political and other pressures can limit the extent of these schemes and the speed at which they are implemented.

Other participants recalled that despite adopting structural adjustment policies with a

view to limiting debt levels, foreign investment is still not flowing. Difficulties related to the ability to import essential equipment, repatriation restrictions and other requirements were mentioned as important impediments in this connection. Other examples were provided, however, of successful adjustments. Participants from some of the South East Asian countries outlined how they have recovered from a high level of indebtedness and are now also experiencing higher direct investment inflows as a result of restricting excessive international borrowing, devaluation, encouragement of investment in specific areas and liberalisation of investment regimes.

While attitudes about attracting international direct investment and about the extent of its contribution to alleviating debt problems differ among developing countries, participants generally agreed that international direct investment could play a positive role and that it should be encouraged. Agreement was readily reached on the common elements that characterise the more successful approaches: good macroeconomic performance and confidence in its sustainability; sound and effective economic policies; open, market-orientated trade and industrial policies and a dynamic private sector; stable and predictable foreign investment policies that provide fair and transparent rules of the game.

Technology

All participants were of the opinion that technology is increasingly shaping international direct investment patterns. There are, of course, many different technologies at very different levels of sophistication, so the possible impact on international direct investment will vary with the technology in question. Nevertheless, there was a broad view that a limited number of developing countries, particularly the NIEs, will most likely benefit from technological advances, but that the outlook for the poorer developing countries, even in respect of the impact of more mature technologies, is more sombre. The new technologies will be transferred to the countries with the capacity to absorb them and the economic and policy environment to attract them. The countries presently fulfilling these conditions are not that numerous.

Participants had different views on the role of more mature technologies in the poorer developing countries. Some felt that the potential to adapt such technologies to the needs and capabilities of these countries, while still maintaining their economic effectiveness, was limited. Others felt that major difficulties lie with the money to buy these technologies and the ability to apply them, but even when these can be overcome, there are still questions as to the contribution mature technologies will make to export competitiveness in a world where the technological content of traded goods is increasing. Participants from the poorer developing countries felt, nevertheless, that mature technologies could make essential contributions to their development. To stimulate this, it was felt that multinational enterprises should be encouraged to help more in the adaptation of technologies, in training labour and in creating a good working environment, while Official Development Assistance (ODA) could be used to develop the infrastructure necessary to attract and support these technologies.

In discussing the possible effects of the new technologies on international direct investment, it was felt by some participants that a real danger does exist that, increasingly, the poorer countries will be cut off from them, particularly if they are unable to attract international direct investment. Other participants expressed less alarm in this respect, concentrating their comments more on what these countries could presently do to broaden and strengthen their technology base and improve or maintain their comparative advantage.

When participants discussed the more advanced technologies, those from the business sector emphasised the growing importance of protecting intellectual property rights (IPRs), given the role of technology in gaining and keeping a competitive edge, and assuring an adequate return on investments in light of the very high costs of R&D and the shortening lifespan of many technologies. For investors, therefore, the protection of IPRs, measures to prevent counterfeiting and other measures which limit technology payments, impose technology transfer or affect ownership and control are increasingly influential in decisions on where to invest.

There was considerable discussion of performance requirements related to technology transfer. Firms clearly seem to want better IPR protection and fewer impediments and performance requirements, but the differences between countries in terms of their level of development and also their political and social situations can result in developed countries and enterprises wanting greater and faster liberalisation than some developing countries believe they are able to pursue. Some participants indicated that the political reality of the situation may compel the use of performance requirements in order for example, to achieve the technology transfer or higher exports needed to help pay for capital goods imports and to offset technology payments.

Other participants commented that it was difficult to target performance requirements and their political rather than economic justification made even more questionable their ability to achieve intended effects. Indeed, if they have an effect, it might very well be at the expense of other competing locations. Also, if performance requirements result in investments being made in less economic locations or somehow "force" technology transfers, this will result in costs which have to be paid by someone, for example, the host country, through higher incentives to attract investments, or the company, via reduced competitiveness and profitability. Some participants suggested that while investment incentives may be used to offset the costs imposed by performance requirements, this is less so in the case of investments in high technology. Other participants commented that, more generally, technologies are steadily causing countries to move towards borderless economies with it becoming increasingly difficult, if not undesirable, to keep things within national boundaries. These participants felt that if countries do not open up and follow liberalisation trends, they would get left behind in world progress and excluded from the network within which economic activities will be increasingly organised.

Participants from some of the countries of South East Asia outlined changes they had made which, in their view, had successfully transformed their economies from ones which were relatively closed and dependent on the exploitation of national resources to ones which are more open and where competitive positions have been gained in world markets in particular technology segments such as semi-conductors. Important aspects behind these changes were felt to be the initiatives taken by the governments concerned in areas such as training and upgrading labour skills, improved infrastructure, privatisation programmes and more open investment policies and strengthened IPR protection. It was felt by these participants that such approaches have met with considerable success in attracting international direct investment which not only exports to world markets but which also demonstrates a strong and long-term commitment to the host economy.

Comparisons between the approaches and experiences of different countries highlighted, for some participants, a number of clear messages. One was that the movement in policies towards international direct investment and technology, which has gone from restrictiveness, through unbundling towards greater openness and fewer restrictions, has demonstrated clear gains. Another was that various restrictions on foreign investments were frequently counterproductive; for example, the preference in some countries for greenfield

investments over local acquisitions ignores that the latter may not only contribute to exports, technology transfer, competitiveness and so on, but may do so more quickly and more cheaply than greenfield investments. These participants suggested, therefore, that host governments focus more on the purpose of the investment and less on its form or modality. A point referred to by many participants was the increasing interdependence between countries and between companies. Business as well as governments must take this more and more into account in their strategies and policies and those who operate outside this framework run a significant risk of getting left behind.

Chapter I

RECENT TRENDS IN INTERNATIONAL DIRECT INVESTMENT

1. ANALYSIS OF RECENT TRENDS IN INTERNATIONAL DIRECT INVESTMENT IN OECD COUNTRIES

A. General trends

In the past forty years international direct investment has played an important role in the growth of the world economy. In many countries, since the end of World War II, the growth of international direct investment and of large multinational enterprises engaged in research, production and distribution activities has been quite unprecedented.

The general slowdown of international direct investment in the mid-1970s¹, after a long period of growth, corresponded to the slowdown of economic activity in general, although in that period, it still remained more buoyant than domestic investment. International direct investment subsequently took off again, after declining somewhat between 1981 and 1982, reaching record levels in 1985 and again in 1986. (see Tables 1 and 2 below).

Table 1. Outward direct investment flows of OECD member countries
(Including reinvested earnings)
\$ million

Cumulative flows			Annual flows					
1961/70	1971/80	1981/86	1981	1982	1983	1984	1985	1986
70 576	301 106	294 403	49 740	23 193	29 545	38 441	60 464	93 080

Source: OECD.

Table 2. Inward direct investment flows of OECD member countries
(Including reinvested earnings)
\$ million

Cumulative flows			Annual flows					
1961/70	1971/80	1981/86	1981	1982	1983	1984	1985	1986
42 060	187 873	218 392	40 821	30 006	31 398	34 347	35 367	47 153

Source: OECD.

Since the end of the 1970s, flows within the OECD area have been more balanced as more and more countries have become actively involved as both inward and outward investors. Until the mid-1970s, the bulk of international direct investment in the OECD countries and the rest of the world came from the United States. Since then, however, international direct investment by the European companies (especially French, German and British) has been expanding and has continued in the 1980s. Nevertheless, and after a very considerable drop in US outward investment in 1982 to 1984, the United States has again become the major source of international direct investment, 1986 outward flows exceeding \$28 billion (see Table A1 at the Annex to this chapter). The United States also became the leading host country for foreign investment, in recent years attracting on occasion more than 50 per cent of total international investment flows. Over the same period, and up to now, most OECD Member countries steadily increased their international direct investment. While the European countries which have traditionally invested abroad are still in a strong position, Japan and Germany now lead the field in outward direct investment, thanks to their continuing balance-of-payments surpluses, the strong appreciation of the yen and the deutschmark, and the dynamism of their enterprises. Besides this, and as a result of actual or threatened trade and investment protectionist measures in major host countries, Japanese firms have also been replacing exports by direct investment abroad.

Investment flows between OECD countries are now better balanced. As can be seen from Tables 3 and 4 below (which summarise Tables A1 and A2 in the Annex) with, for example, the United States being still one of the leading investors as well as now a major beneficiary of inward investment, whereas inward investment into Japan remains very modest in comparison to its outward investment flows, the balance of international direct investment by European countries shows that overall they have invested more abroad than they have received in inward investment in recent years, which would also seem to confirm the trend towards a more balanced distribution of international investment flows between OECD countries (as seen from Table 5 below).

Before discussing the broad forces which have shaped these recent trends the above remarks concerning the general trend of international direct investment in recent years require considerable qualification and comment, particularly as regards exchange rate movements and the role played by reinvested earnings in international direct investment.

The dollar, which had depreciated against the other major currencies in the late 1970s, moved in the opposite direction during the period 1980-1984 before beginning to fall again. The steep rise in the dollar between 1980 and 1984 pushed up the cost of foreign investment in the United States and, by the same token, reduced the cost of US investment abroad. However, international direct investment flows towards the United States do not seem to have been all that strongly influenced by these fluctuations in the dollar exchange rate. The same thing has been happening in Japan since late 1985. The steep appreciation of the yen has made investment in Japan more costly, but foreign investment in Japan has continued at a brisk pace. Neither has the further fall in the dollar since 1986 reduced the flow of foreign investment by US firms which have tended to move into new sectors and principally into new technologies with the object of gaining market shares and financing their future growth. US firms want to be present both in Japan, in order to benefit from the new technologies to be found there, and in Europe, in order to be prepared for the single European market on 1st January 1993. The fact that currency fluctuations do not appear to have had all that major an impact on international direct investment flows is a reflection of the importance of actual and expected growth for major markets and that cost factors, albeit important, are only one element in the decision to undertake international direct investment. Companies may be willing or have to undertake more expensive investments if

Table 3. Inward direct investment flows

US\$ million

	Cumulative flows ¹			
	1971/80	%	1981/86	%
United States	56 276	30.0	118 420	54.2
Japan	1 424	0.8	1 902	0.9
France	16 908	9.0	12 777	5.9
Germany	13 959	7.4	5 795	2.7
United Kingdom	40 503	21.6	29 686	13.6

1. Including reinvested earnings.
Source: OECD.

Table 4. Outward direct investment flows

US\$ million

	Cumulative flows				Direct investment flows ¹					
	1971/80	%	1981/86	%	1981	1982	1983	1984	1985	1986
United States	134 354	44.4	55 780	18.9	9 620	-2 360	380	2 820	17 270	28 050
Annual	13 435		9 297							
Japan	18 052	6	39 943	13.6	4 894	4 540	3 612	5 965	6 452	14 480
Annual	1 805		6 657							
France	13 940	4.6	19 101	6.5	4 615	3 063	1 841	2 126	2 226	5 230
Annual	1 394		318							
Germany	23 130	7.7	28 265	9.6	4 097	2 783	3 170	4 401	4 815	8 999
Annual	2 313		4 711							
United Kingdom	55 112	18.2	65 455	22.2	12 065	7 143	8 138	8 098	11 320	16 691
Annual	5 511		10 909							

1. Including reinvested earnings.
Source: OECD.

Table 5. Balance of international direct investment¹

US\$ million

	1980	1981	1982	1983	1984	1985	1986
Canada	2 010	9 426	1 540	2 515	965	5 894	2 138
France	-189	2 189	1 500	210	-72	16	2 481
Germany	3 756	3 757	1 958	1 375	3 661	4 087	7 632
Italy	167	258	389	936	705	815	2 829
Japan	2 117	4 705	4 101	3 196	5 975	5 810	14 524
Netherlands	3 695	2 963	2 188	2 341	3 430	2 002	2 105
United Kingdom	1 234	6 174	1 856	3 006	8 339	5 646	8 746
United States	2 300	-15 570	-16 160	-11 580	-22 570	-1 760	3 000

1. Including reinvested earnings.
Source: OECD.

they are to follow developments in the markets concerned. These would appear to continue to be powerful forces given the investment patterns described above.

Reinvested earnings are an integral part of international direct investment flows and should therefore be taken into account in assessing the global evolution of these flows. Reinvested earnings have come to represent a significant part of international direct investment flows for a number of countries and even a major part for some countries with a long tradition of international direct investment. Unfortunately, it is not always easy or possible to make comparisons on this basis, since data on reinvested earnings are available for only a few OECD countries and in the others have to be estimated. Also, the differences in the statistical definitions used for data on reinvested earnings seem much more marked than in the case of the other components of capital outflows that come under the heading of direct investment.

Turning to recent developments concerning the sectoral structure of international direct investment a key feature is the growing importance of international direct investment in services. The share of services in outward direct investment amounts to some 40 per cent of the stock of outward direct investment, as shown by R. McCulloch². In the case of the United States, there has been large-scale outward investment in services since 1950, but its composition has changed: the share of transport and communications has declined, while recently the highest rate of investment has been in financial services and insurance. Between 1977 and 1986 the stock of United States direct investment in services doubled, from \$60 billion to \$119 billion, representing 43 per cent of all direct investment. The bulk of investment in the financial and insurance sectors is directed to the United Kingdom, Switzerland and the Caribbean. The United States is also a leading host country for investment in services, with a stock of \$90 billion in such investment in 1985. In terms of flows, investment in services represented nearly 50 per cent of inward direct investment in the United States between 1981 and 1986.

Direct investment in services has also been an important element in the growth of the stock of outward direct investment by Japan and Germany. Direct investment by Japan rose by \$61 billion between 1977 and 1985, of which 62 per cent was in services, with a large share going to the newly industrialising countries. Since 1985, services have accounted for about 50 per cent of the stock of direct investment in France, the United States and Germany, and 40 per cent in the Netherlands, Italy and Denmark. The figures are even more striking when expressed in terms of investment flows: in the period 1980-86, 70 per cent of investment flows to Canada and Germany were in services; the corresponding figure for the United Kingdom being 60 per cent, and 50 per cent for France, the United States and the Netherlands (see Table 6).

The growth of international direct investment in services reflects, among other forces, the prospects for expansion in a number of markets following technological innovations in areas such as electronics, computer services and telecommunications. These developments are having important repercussions on the structure and strategies of multinational enterprises and as addressed in a recent work of the organisation on the impact of new technologies on international direct investment³, eventually may lead to significant changes in the location of particular investments.

The principle factors determining the broad patterns and trends in international direct investment described above are the general economic conditions, the policies of home and host countries and, as indicated above, technological developments and the strategies of multinational enterprises. In the late seventies and early eighties the single major force influencing the slowing down of international direct investment was the unsettled global economic situation which followed the steepest recession since the 1930s. During the last

Table 6. Share of services in international direct investment

Percentage		
	1975-80	1981-85
Outward direct investment		
Japan	41.8	62.2
Germany	49.1	58.4
United States	34.3	53.2
France	44.1	43.5
United Kingdom	43.6	38.2
Canada	20.2	30.9
Inward direct investment		
Germany	68.9	72.8
Canada	58.8	69.9
France	61.6	64.5
United Kingdom	36.8	59.1
United States	43.7	48.6
Japan	27.8	31.0

Source: OECD, from UNCTC and OECD documents.

several years there has been considerable improvement in the world economic situation, with greater confidence in the resilience and sustainability of the recovery which has also now diffused more broadly in the OECD area and in parts of the developing world. However, the emergence and persistence of severe debt problems in some developing countries, particularly in Latin America, has been an important negative influence on the level of business confidence and uncertainty, particularly with respect to international direct investment in these countries. This latter aspect is dealt with in more detail in Section 2 of this chapter.

Not only have the more favourable economic conditions in OECD countries made it possible for both domestic and international investment to take off again, but in addition Member countries' policies have moved towards a higher degree of liberalisation of international direct investment and, on the whole, a fairly broad based dismantling of measures to control investment.

The OECD's efforts to promote liberalisation of international direct investment are conducted, in particular, through its work on the Code of Liberalisation of Capital Movements (which addresses the entry of investment into a country and right of establishment issues) and its work under the 1976 OECD Declaration on International Investment and Multinational Enterprises, in particular as it refers to National Treatment (which addresses the issue of investment by foreign controlled enterprises, once established in the host country. Since the adoption of these instruments, OECD Member countries have been committed to the progressive liberalisation of international capital movements and direct investment flows and as the record shows these efforts have been associated with the strong and broadly based movement towards liberalisation in OECD Member countries.

Broadly speaking, foreign investment in the OECD countries began to take off when questions concerning the ownership and control of national industries and resources were no longer uppermost and when attention turned to the positive contribution that such investment can make, rather than the potential issues and problems which it may pose for host

countries. From then on, liberalisation gained impetus in the second half of the 1970s and continued all through the 1980s, including countries such as those of Scandinavia and southern Europe that had traditionally been less liberal, and in Australia, Canada and New Zealand. From 1973 on, Japan substantially reduced its controls on inward direct investment and, at the beginning of the 1980s, the remaining restrictive measures concerned only a few sectors.

Another example of liberalisation is the proposal to create a single European market by 1st January 1993. At stake here is not only the removal of barriers to the free circulation of goods and capital between the Twelve but also the removal of barriers between the Twelve and their trading partners. Also, Community research programmes such as ESPRIT and RACE are likely to attract a certain amount of foreign investment by firms wishing to take advantage of the research opportunities offered by the Community and to be on the spot in 1993.

The deregulation and privatisation programmes under way in the various OECD countries also provide opportunities for inward direct investment. For example, the deregulation of the banking sector in the United States has facilitated foreign investment in that sector. Similarly, the divestiture of AT&T in 1984 modified international competition in the telecommunications field and opened up the US market to European and Japanese suppliers of telecommunications equipment. The privatisation programmes embarked upon by Japan, the United Kingdom and France also offer major investment opportunities for foreign firms. The recent moves towards increased liberalisation of the telecommunications, banking and financial services sectors seems indicative of a trend that is set to continue.

Some countries, however, still have general screening procedures (e.g. the 1985 Investment Canada Act and, in Australia, the 1987 Foreign Takeover Act Amendment). Also, a number of sectoral restrictions still exist in a number of countries. For example, international direct investment may be restricted in natural resource sectors (land, forestry and extractive industries), energy (in particular oil), services, especially transport (domestic air routes, shipping and especially coastal shipping), communications (press, radio, television and telecommunications) and insurance. These restrictions may involve either an outright ban or, more often, a number of conditions on international direct investment, such as limits on the proportion of the company's capital that may be foreign-owned, or on voting rights, requirements concerning the local content of products, and other prior conditions or performance requirements.

Despite the broad move towards liberalisation of investment regimes, recent years have nevertheless witnessed in some countries an emergence of investment protectionist sentiments which raise potential risks for the climate for international direct investment. The causes of this are varied, but they are frequently related to existing international trade frictions overlapping into the investment area. For example, in the United States, and in a climate where protectionist pressures had already built up, the above-noted upsurge of inward direct investment in general, but also with respect to that of Japanese investors, gave rise to a public debate on the merits of that investment, a debate not too dissimilar to those which took place in other countries in the 1960s.

This debate has tended to stress possible threats to national security of foreign penetration of sectors related to defence or other sensitive sectors and threats to the national interest of the control of significant portions of key domestic industries by foreign enterprises, the fear being that the country's innovative capacity will be thereby curbed. In addition, there is the additional concern that foreign companies, including those from major trade surplus countries are buying up American companies and resources at below real market value. In fact, a major feature of international direct investment in the United

States has been the very high upsurge in acquisitions of United States firms by foreign companies. Inevitably, the debate has influenced legislators and initial versions of the Omnibus Trade Bill contained a number of proposals that would have reinforced controls on inward direct investment. Most of these proposals were subsequently dropped; the major investment element in the Bill which has been adopted by Congress concerns the power to block acquisitions of US companies by foreign investors that would impair national security.

Another illustration of events which may be damaging to the climate for international direct investment can be found in the allegations that recent foreign investors – such as from Japan or from South East Asia – have had recourse to so-called “screwdriver operations” (assembly plants for imported components with little local value-added) with the motivation of circumventing import regulations. This is often seen in Europe as a trade question rather than an international investment matter, but some officials have stated that this sort of investment is not necessarily welcome. Recent changes to European Community trade legislation are indicative of increasing pressures in certain industries to launch anti-dumping investigations of the activities of some Japanese manufacturers in connection with the supply of components to their European plants. If such pressures were to become generalised or to prevail, the operations of a number of foreign enterprises established in European countries might be affected.

Unjustified pressures of a restrictive nature are indeed worrisome, signalling some policy movements in a direction contrary to the liberalisation of international direct investment, particularly when taken by countries with generally liberal regimes and because they may reinforce parallel pressures elsewhere or at least forestall further progress to liberalisation. As such, protectionist moves should not be underplayed, but equally they must be set in the context of the overall developments in investment regimes in Member countries. For example, work recently completed by the Organisation on incentives and disincentives to international direct investment⁴ has shown that, in the main, countries are increasingly turning to a relaxation or removal of controls and impediments to international investment rather than the award of various fiscal and financial incentives as a key element in attracting such investment.

B. Changes in the geographical and sectoral pattern of international direct investment

This section analyses in more detail the changes that have taken place in the geographical and sectoral pattern of international direct investment flows; it examines inward and outward investment in and by the United States, Japan and the European countries.

United States

The period since 1980 has seen a number of important changes in United States inward and outward investment patterns. Principle among these has been the very considerable expansion of inward investment and the resurgence of outward investment since 1985 after a very sharp fall in the period 1982 to 1984. This section looks first at the changes in inward investment and the issues to which these have given rise and, secondly, at the outward investment situation.

For the 1981-86 period, annual inflows to the United States averaged around \$20 billion and accounted for over 54 per cent of total inward investment in OECD countries, in comparison to 30 per cent for the 1970s as a whole (see Table A2 at Annex). After some

Table 7. Stock of international direct investment
in the United States

US\$ billion				
1975	1980	1983	1985	1986
27.7	83.0	137.1	184.6	209.3

Source: US Survey of Current Business (various issues).

fall-off in 1982 and 1983, inward flows have expanded again reaching over \$25 billion in 1986, a level similar to that in 1981. In terms of stocks, these increased from \$27.7 billion in 1975 to \$83 billion in 1988 reaching \$209.3 billion in 1986 (see Table 7).

Most OECD Member countries have stepped up their investment in the United States. Investment into the United States from Europe increased in the same proportion as total inward investment into the United States. It seems that European firms have been attracted by the strong performance of the US economy; however, an added incentive to invest in the United States has been the desire to benefit from the new technologies being developed there. Principally since 1985 foreign investors have also benefited from other favourable developments such as the fall in the dollar and the wave of industrial restructuring in the United States and, under the combined pressure of these two factors, many US firms of interest to foreign investors have come up for sale.

Unlike their European counterparts, Japanese firms had only a limited presence in the US in 1975, but by 1986 the stock of Japanese investment had risen to 11 per cent of total inward investment. Japanese direct investment, like its European counterpart, was attracted to the United States by the scale of the market and by new technologies but also, and this is more specific to Japanese investment in the automobile sector, as a reaction to actual and potential protectionist barriers to imports from Japan. The United States has taken a growing share of Japanese direct investment – as much as 50 per cent of it in some years. Most of this investment is fairly recent, two-thirds of it dating from after 1981. Investment has been concentrated particularly in banking, finance, the wholesale trade and manufacturing (see Tables A3, A4). Although until recently Japanese multinationals preferred to invest in the United States via subsidiaries, they have begun, particularly since the fall in the dollar in 1985, to invest via mergers, takeovers of existing firms, and joint ventures, in the latter case chiefly in the automobile industry.

Changes in the investment position of the United States should be seen in the light of the depreciation of the dollar, and in the light of the substantial flows between the United States and offshore banking centres, particularly the Netherlands Antilles, mainly since 1979. The picture of the United States as a foreign investor as given by the statistics has been significantly affected by the financial subsidiaries that were set up in the Netherlands Antilles by US parent companies to allow them to borrow on the Eurodollar market while ensuring that the resulting interest payments avoided withholding tax in the United States, as provided for under a convention. In illustration of the importance of the associated financial flows, intercompany debt flows approached \$8 billion in 1984. During the third quarter of 1984 the US Government abolished the aforesaid tax with respect to interest paid on portfolio debt to non-residents of the United States. As a result of this there ceased to be any particular point in going through the Netherlands Antilles to raise funds. US firms then began to borrow directly on European markets and started to pay back the loans

from their subsidiaries in the Netherlands Antilles. This explains the change of sign that occurred in the net flow of intercorporate debt between the United States and the Netherlands Antilles from 1985 onwards. This borrowing served to finance transactions in the United States, since the less favourable economic conditions abroad were an inducement to invest at home rather than to set up, expand or acquire subsidiaries abroad⁵.

Another, more recent factor, that has had an impact on investment in the United States was the Tax Reform Act of 1986. According to some US experts, this Act, which was passed by Congress in September 1986 and came into force on 1st January 1987, was a key factor in the wave of takeovers by foreign firms that took place in late 1986. Under the Act, capital gains are now taxed at the same rate as ordinary income (with a maximum rate of 28 per cent in 1987), whereas previously they were taxed at a rate of 40 per cent of ordinary income tax (which meant an effective maximum rate of 20 per cent). This change in the tax law was a strong inducement to sellers of assets to complete their transactions before end-1986. Purchasers were also encouraged to complete their transactions before the end of 1986, following the modification of the "Accelerated Cost Recovery System" (ACRS) which lengthened the period over which assets had to be depreciated, thereby making the system of depreciation less advantageous.

More generally, the analysis of the effects of changes in fiscal policy on international investment flows is not conclusive. Nevertheless, quite a number of OECD countries have, in recent years, undertaken important fiscal reforms, including those which are major home and/or host countries to international direct investment such as Canada, France, Germany, Japan, the United Kingdom and the United States. These changes are as yet too recent to provide hard evidence on their possible impact on international direct investment patterns but there may be some rethinking as to where to set up new operations and a review of existing ones. What does seem clear is that foreign investors may now have to pay greater attention to international differences in tax rates when considering international investment decisions and that tax factors have become relatively more important now due to the liberalisation of restrictions on international direct investment.

Despite their rapid growth in international direct investment in the United States, it is quite clear that, in terms of penetration, foreign presence is still relatively low when the share of inward direct investment in total fixed investment in the United States is compared with that of domestic investment (see Table 8 below). Similarly, the share of foreign firms

Table 8. Stock (book value) of international direct investment in the United States as a percentage of investment by US firms in the United States

1950	0.6
1960	0.6
1966	0.5
1974	0.7
1977	0.7
1980	1.2
1982	1.5
1985	1.6

Source: Federal Reserve Board, 1986.

**Table 9. Employment in the US subsidiaries of foreign firms
as a proportion of total employment**

	Percentage				
	1974	1977	1980	1982	1984
Extractive and oil industries	16.8	13.0	12.4	14.5	16.1
Manufacturing	2.7	3.5	5.4	6.6	7.1
Construction	0.2	0.3	1.0	1.3	1.0
Industrial goods	2.8	3.3	5.0	6.2	6.4
Wholesale trade	2.8	3.2	4.1	5.3	5.3
Retail trade	1.0	1.0	2.0	2.6	2.7
Finance, insurance and real estate	1.1	1.1	2.1	2.3	2.2
Services and trade in services	1.0	1.0	1.6	2.1	2.2
As percentage of total employment	1.6	1.8	2.7	3.3	3.5

Source: R. Lipsey and the United States Department of Commerce, 1986.

in employment was only 3.5 per cent of total employment in the United States in 1985 (see Table 9). Such data suggest that foreign investment still plays only a marginal role in the US economy although its importance for some specific sectors or regions is, nevertheless, considerable.

Looking at the stock of foreign investment in the United States in 1986 it can be seen from Table 10 that European firms still control two-thirds of it. In 1985 the United Kingdom and the Netherlands alone accounted for over 40 per cent of foreign investment. Japan's share of the stock was then relatively small, since Japanese firms arrived on the scene later than their European counterparts.

The shares of the various countries in international direct investment in the United States also vary according to the type of industry: for example, the Netherlands and the

**Table 10. Stock of foreign investment in the United States
in 1986, by origin**

	Percentage of total
Canada	9
Europe	66
France	3
Germany	8
Netherlands	20
United Kingdom	24
Switzerland	6
Japan	10
Latin America	9
Netherlands Antilles	6
Middle East	3
Kuwait	2

Source: The United States Department of Commerce, 1986.

United Kingdom account for 80 per cent of investment in the oil industry; they also provide 40 per cent of investment in manufacturing, the remainder coming from France (9 per cent), Germany (10 per cent) and Switzerland (12 per cent). Japanese investment is heavily concentrated in wholesale trade, accounting for over 40 per cent of foreign investment in that sector which until now benefited from aid from several states. Japan also plays an important role in investment in banking, with over 20 per cent of investment in that sector. Most of the investment originating from Latin American countries came from the Netherlands Antilles and was concentrated in real estate. Major changes in the pattern of investment seem unlikely in coming years, apart from a decline in investment from the Netherlands Antilles, and the above-mentioned trends will probably continue.

Unlike US firms, which expanded internationally at a very early stage, foreign firms set up in the United States much later. This can be seen by comparing the degree of maturity of US investment, most of which was in the form of reinvested earnings between 1984 and 1985, with that of foreign investment in the United States, which expanded over the same period predominantly via equity participation and loans.

The growth of foreign direct investment in the United States in recent years has given rise to a number of criticisms; the same criticisms are also to be heard in a number of other OECD countries, although they are voiced perhaps a little less forcefully. The Tolchins, in their book *Buying into America*⁷, summarise the main allegations as follows:

- by setting up in the United States, foreign firms acquire US technology which they then export to their home country, thereby depriving the United States of the potential spin-offs from their own technology;
- when foreign firms invest in the United States they often do so in the form of assembly plants, with the aim of circumventing import controls, and then import components, which has an adverse effect on the trade balance. Furthermore, they create few jobs;
- the incentives offered by some State governments in the United States to Japanese and West European investors in the form of tax exemptions or financial aid place domestic firms at a disadvantage and give foreign firms a competitive edge over them; such incentives reflect a short-term view of the economy;
- some US firms have also complained about the lack of reciprocity on the part of foreign countries when it comes to inward investment in certain sectors or activities.

Alongside the critics of foreign direct investment, there are those who take a much more favourable view, arguing that such investment is a source of new jobs and funds and helps to keep interest rates low. They say that one should see the benefits to be had from international direct investment instead of harbouring fears about a liberal approach to international direct investment. This is the approach taken by the United States government, seeing international investment as benefiting both host and home countries. More generally, and for some time now, host countries have been focusing more on the advantages to be gained from international direct investment, and keeping whatever controls or measures they have, which are geared to ensuring such benefits, to a minimum. Also, and in respect of the allegation noted above on the role of investment incentives, a study conducted by the Organisation⁸ shows that while considerable investment incentive programmes exist in most countries, the incentives on offer (at national or sub-national levels) are generally available to all enterprises, regardless of their origin. In addition, and as concerns "screw-driver operations", criticism, at least in the United States, has become more muted as

foreign-owned factories have begun to buy more inputs from existing companies. Moreover, individual states do welcome assembly plants. Also, and as already mentioned, early versions of the Omnibus Trade Bill contained a number of restrictive proposals most of which have not been included in the version recently adopted by Congress.

Turning to outward investment, the United States is still one of the major sources of international direct investment but its position has changed quite significantly over the 1981-86 period as well as in respect of its position in the 1970s. United States outward investment flows in 1985 and 1986, at \$17 billion and \$28 billion made it the single largest source of international direct investment. For the 1981-86 period as a whole, the United States accounted for 19 per cent of total outward flows from OECD countries (in comparison to 22 per cent for the United Kingdom and 14 per cent for Japan) as opposed to over 44 per cent of such flows for the 1970s. Thus, while remaining a major source country, its relative position has declined significantly in part due to the growth of outward investment by other countries, but also due to very low (and sometimes negative) outflows between 1982 and 1984.

On the basis of the stock of international direct investment, the United States still accounts for over 40 per cent of the total stock of investment in the OECD countries. US foreign investment on the whole predated other countries' investment in the United States by quite some time, and took place when asset prices were substantially lower, so that it is undervalued as compared with foreign investment in the United States. It has been growing at an average annual rate of 20 per cent since 1980, up from an annual rate of 18 per cent during the 1970s. Considering the higher inflation rate during the 1970s, the real increase has been much larger than the nominal figures indicate.

The geographical pattern of US investment abroad has remained virtually unchanged between 1980 and 1986, the OECD countries still receiving over 70 per cent thereof. In 1986 the largest proportion of investment went to Canada. US investment in Canadian oil operations and manufacturing accounted for over 20 per cent of US investment in these sectors. The recent trade agreement signed between the United States and Canada, can only accentuate this trend and increase the overall flow of investment between the two countries. Another country that receives a large share of US investment is the United Kingdom, followed by Germany and the other European countries. Japan, too, is becoming a major host country for US direct investment. From 1980 to 1986 the US investment position in Japan, starting from a small base, increased by 82 per cent, particularly on account of the yen rise which swelled the dollar value of reinvested earnings. The pattern of US direct investment in the developing countries has changed somewhat. US investment in the Asian countries as a whole rose steeply after 1980 and also increased in the Middle East, although to a lesser extent. Investment in Latin America was flat, except for Brazil.

Japan

Another important trend in international direct investment has been the emergence of Japan as both a major investor in its own right and a new host country for foreign investment. Up to the late 1960s foreign investment in Japan was very limited and accepted by the Japanese government only on a case-by-case basis so as to enhance the technology and management skills of Japanese firms through a careful choice of imported technologies. Most of the governmental barriers to investment that used to exist have now disappeared and since 1980 foreign investment in Japan has risen by 16 per cent a year on average. Direct investment flows into Japan for 1981-86 averaged \$317 million per annum, in comparison to \$142 million per annum over the seventies. Indeed, more investment has

taken place in Japan in the 1981-86 period than during the previous thirty years. Foreign firms see the size and sustained growth of the Japanese market and the high-performance technologies to be found there as offering a number of investment opportunities, and realise that in order to benefit from those technologies they must be present in the market.

Although international direct investment in Japan has increased significantly since the beginning of the eighties, it is still well behind Japanese outward direct investment. This is due partly to the restrictions imposed in the past. Over a relatively short time, however (1973 to 1980) Japan went ahead with liberalising international direct investment, and by the beginning of 1980 the last remaining restrictions on direct investment apply to only a few sectors. The chief remaining difficulties facing foreign investors arise from the complexity and high cost of setting up business in Japan, which is all the more expensive due to the current steep rise in the value of the yen. In addition, a number of factors related to Japanese business practices are still tending to limit direct investment in Japan. These include systems of distribution that seem too complex in the eyes of Western investors, practices such as returning unsold merchandise to the manufacturer, discounts offered to retail traders – all transaction costs to which Western firms are unaccustomed. When other factors such as life-time employment, high wage costs, high property prices and the competitive strength of domestic firms in many sectors, are added, foreign firms could well be deterred from investing in Japan. In fact, however, international direct investment in Japan has grown rapidly over the past five years. Foreign investors in Japan at present tend to opt for subsidiaries over joint ventures as the means of introducing their products, services and technology into the Japanese market; acquisitions of stakes in Japanese firms are becoming increasingly frequent, although acquisitions of majority interests are still rare, since Japanese firms are usually not interested in a foreign takeover.

Also, and although in the early 1970s investment in Japan was less profitable than in other countries, the rate of return on investment in Japan is now altogether comparable with that to be had in other OECD countries (see Table 11). Furthermore, the steep rise in the yen against other currencies in 1985 and 1986 neither damped the flow of international direct investment to Japan nor led to the withdrawal of foreign firms already present in the country, most of which have every intention of stepping up their production in Japan, as shown by a recent study by Booz, Allen and Hamilton⁹.

The main reason for this new direct investment strategy by foreign firms in Japan is their desire to gain inside access to Japanese technology and to be able to keep close track of how it is evolving; indeed, Japanese technology is attracting an increasing number of firms in leading-edge sectors such as new materials and biotechnologies. Another reason is that a local manufacturing operation is often the key to gaining a firm foothold in the Japanese market; frequently it is the only way to meet delivery deadlines or to tailor

Table 11. Rate of return on United States outward direct investment, by area

	Percentage									
	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985
Japan	23	14	24	13	13	14	9	15	9	17
Europe	11	12	15	21	17	12	9	8	7	19
Rest of world	16	14	15	21	18	17	12	11	11	9

Source: Booz, Allen and Hamilton.

Table 12. Cumulative investment in Japan

	Percentage					
	1972	1975	1980	1984	1985	1986
United States	66	66	54	49	48	49
Europe	18	21	23	22	24	27
Others	16	19	23	29	28	24
Total (US\$ billion)	1.0	1.5	3.0	5.5	6.4	7.4

Source: Ministry of Finance, Tokyo.

products to the needs of the Japanese customer, and also to take advantage of a stable work force and the latest Japanese management methods (e.g. Kanban).

US firms are still the leading foreign investors in Japan, as seen from Table 12, accounting for 49 per cent of total cumulative investment, followed by Europe with 24 per cent. The share of US firms in total inward investment into Japan has declined since the 1980s, but this is due more to the emergence of new investors than US firms becoming less interested in the Japanese market. In terms of industrial sectors, and as seen from Table 13, chemical and pharmaceutical firms have been the largest investors in Japan, increasing their investment at an annual rate of 15.5 per cent since 1981. The machine tool industry has caught up with the chemical industry, with an annual rate of increase of nearly 20 per cent since 1981. Investment in the new materials, biotechnology and superconductor sectors is rising constantly. By contrast, investment in the oil industry seems to be falling.

Nonetheless, the level of foreign investment in Japan is still low, especially if it is compared with that of Japanese outward investment (Tables A5 and A6 at Annex)¹⁰. Although it is true that up to the mid-1970s Japan placed a number of restrictions on inward investment, it is also true that foreign investors did not regard the country as a priority investment area. But although policies and priorities have changed, foreign firms still play only a marginal role in Japan, accounting for less than 2 per cent of sales and less than 1 per cent of jobs in Japan. US firms alone have invested ten times as much in Europe as in Japan. In 1986, European investment in Japan was also much smaller than Japanese investment in Europe. The Ministry of International Trade and Industry (MITI) has calculated that Japan has invested four times as much in the United States and Europe as

Table 13. Breakdown of international direct investment in Japan, in 1986, by sector

Percentage			
Machine tools	24	Food	2
Metallurgy	6	Other products	5
Chemicals	24	Commerce	13
Oil	8	Services	5
Glass and ceramics	2	Others	12 ¹

1. A major part of this is represented by investment in biotechnology.

Source: Ministry of Finance, Tokyo.

both of them have invested in Japan. Tables 14, 15 and 16 illustrate these differences in international direct investment in and by Japan.

Particularly since the beginning of the eighties, Japan has emerged as a major source of international direct investment, accounting for nearly 14 per cent of total outward flows from OECD countries in the 1981-86 period in comparison to 6 per cent for the 1970s. From 1981 to 1985, Japanese outward investment averaged about \$5 billion per annum, and 1986 witnessed a major jump to \$14.5 billion (see Table A1).

Between 1980 and 1985, the number of Japanese subsidiaries abroad increased by 30 per cent and the competitiveness of the Japanese multinationals strengthened Japan's position as an international investor. The above developments in Japanese outward investment have also been associated with a switch from investment in commercial activities to production investment – the surplus funds that Japanese firms have at their disposal and their fears that protectionist barriers will be raised in the main US and European markets helping to explain this. The steep rise in the yen has also prompted Japanese firms to expand their overseas production, to meet not only foreign but also domestic demand. Besides using direct investment as a means of commercial penetration, Japan has also seen it as a means of gaining access to foreign technology via joint ventures or cross-licensing agreements.

Table 14. Cumulative international direct investment in and by Japan

US\$ billion

	1975	1980	1985	1986
Japanese outward investment	9.7	17.6	38.6	51.1
Inward investment in Japan	1.5	3.0	6.4	7.4

Source: Ministry of Finance, Tokyo. Including share investments, excluding debt.

Table 15. Cumulative international direct investment by the US in Japan and by Japan in the US

US\$ billion

	1975	1980	1985
US investment in Japan	0.9	1.6	2.7
Japanese investment in the US	2.5	5.3	12.2

Source: Ministry of Finance, Tokyo. Including share investments, excluding debt.

Table 16. Cumulative international direct investment by European countries in Japan and by Japan in Europe

US\$ billion

	1975	1980	1985
European investment in Japan	0.3	0.9	1.2
Japanese investment in Europe	1.6	2.8	5.7

Source: Ministry of Finance, Tokyo.

Table 17. Japanese investment flows to the developing countries

	US\$ million			
	1984	1985	1986	1987
Latin America	2290	2616	4737	4816
Asia	1629	1436	2327	4868
Africa	326	172	309	272

Source: JETRO, 1988.

The foregoing remarks would suggest that Japanese investment abroad will continue to grow at its present rate. But the pattern of Japanese direct investment abroad has been changing, particularly since 1985, as a result of the appreciation of the yen (although as has already been mentioned the rise in the value of the yen has so far not affected international inward direct investment in Japan). As noted earlier, Japanese overseas investment increased steeply in 1986, an increase ascribable, first, to the steady increase in excess liquidity in Japan and, second, to increased purchasing power abroad as a result of the rise in the yen. The features of recent Japanese direct investment differ fairly markedly from those of similar investment in the 1970s. First, investment in the non-manufacturing sector – finance, real estate and commerce – has risen, accounting for over 70 per cent of total Japanese investment. Second, the proportion of direct investment in the industrialised countries is growing and in 1985 represented over 50 per cent of total investment. Third, there has been a structural shift from investment in labour-intensive or raw material processing sectors to more capital and technology-intensive sectors. After falling off between 1981 and 1983, Japanese investment in the developing countries has picked up again since 1985, to the benefit of both South-East Asia and Latin America (as seen in Table 17).

Europe

In the ten years between 1975 and 1985, Europe, after having been the premier host region for international direct investment, became the world's leading foreign investor, primarily in the United States. The main investors are France, Germany, the Netherlands and the United Kingdom, which together account for 90 per cent of investment flows to and from Europe. It was the United Kingdom and Germany that saw the biggest expansion in their direct investment abroad over the period 1981-1986, despite a certain slowdown (in percentage terms) since 1984 (see Tables A7 to A12 at Annex and Table 18 below) which shows how the share of certain EEC countries in international direct investment by the OECD countries has changed). Since early 1985, European investment in the United States has speeded up, the depreciation of the dollar and major restructuring efforts in the United States facilitating takeovers of US firms. There has also been the attraction of the growth in US markets, together with the relatively high profits to be made, compared with slower growth in some parts of Europe. Mention should also be made of the large amount of intra-European investment that can be expected to take place with a view to achieving economies of scale by the time the Single European Market comes into force on 1st January 1993.

At the moment the United Kingdom, the Netherlands, Germany and France are the leading outward investors, and it seems that they will remain so in coming years; the first

two countries still account for most foreign direct investment from Europe. Most investment flows from EC countries are directed to other EC countries and to the United States, as may be seen from the Tables in the Annex showing the flows of outward direct investment by country. For this there are two explanations: the completion of the single European Market by the end of 1992 represents a major growth opportunity for European companies; the lower costs, economies of scale and enhanced competitiveness that should result from it will create new investment opportunities. Firms will want to be as competitive as possible to cope with the new expanded market. Equally, non-EC firms are wishing to establish subsidiaries in the EC in order to be in a position to share in the advantages of the "single market". This is likely to mean that some firms, including those where the investment has a long gestation period, will already have been investing in anticipation of 1993, and as that date approaches more are likely to follow. Also, as was mentioned earlier, European firms are turning increasingly to the United States; this is the case of firms in the Netherlands, the United Kingdom, France, Italy and Germany. Belgium and Luxembourg, which prior to 1983 invested relatively little abroad, are now starting to expand their investment. Furthermore, since 1983 there has been a steep increase in foreign investment by a number of non-EEC European countries such as Switzerland and Sweden¹¹.

At the same time, the share of European countries in total OECD inward direct investment has fallen, apart from that of the United Kingdom. (see Table 19 below).

Table 18. Outward direct investment flows from selected European countries as a percentage of investment by the OECD countries

	1971/80	1981	1982	1983	1984	1985	1986
France	4.6	9.28	13.2	6.57	5.53	3.68	5.62
Germany	7.7	8.24	12.0	10.73	11.45	7.95	9.67
Italy	1.2	2.82	4.42	7.2	5.19	3.01	2.85
Netherlands	9.2	9.52	14.31	12.75	13.28	5.21	4.50
Switzerland	n.a.	n.a.	n.a.	n.a.	2.96	7.56	1.46
United Kingdom	18.0	24.25	30.08	27.54	21.07	18.72	17.93

n.a. Not available.

Source: OECD.

Table 19. International direct investment flows to selected European countries as a percentage of the inward investment received by the OECD countries

	1971-80	1981	1982	1983	1984	1985	1986
France	9.0	5.94	5.21	5.19	6.21	6.25	5.83
Germany	7.4	0.83	2.75	5.72	2.15	2.05	2.90
Italy	3.0	2.81	2.12	3.79	3.65	2.84	-0.36
Netherlands	5.8	4.34	3.77	4.54	4.88	3.24	4.41
Switzerland	n.a.	n.a.	n.a.	0.91	1.51	2.97	2.98
United Kingdom	21.6	14.43	17.62	16.34	-0.68	16.04	16.85

n.a. Not available.

Source: OECD.

Japanese firms have been expanding their investment in Europe, their preferred investment locations being the United Kingdom and the Netherlands, Luxembourg for financial investment (with a very big increase in 1986), followed by France and Germany (see Table 20 below). After an average annual growth exceeding 30 per cent between 1980 and 1985, Japanese foreign direct investment in Europe has since grown very strongly – in 1986 it grew by 80 per cent to \$3.7 billion and by a further 90 per cent in 1987, to \$6.6 billion. This jump has resulted, as noted above, from the financial surpluses of Japanese companies, the high value of the yen and the expectations of Japanese investors concerning the single European Market in 1993. The major recipient countries, especially in 1986 and 1987, have been the United Kingdom and Luxembourg, but it may also be mentioned that Japanese investment in Spain starting from a low base in 1986 tripled in 1987.

Table 20. Japanese investment in Europe
US\$ million

	1984	1985	1986	1987
United Kingdom	318	375	984	2 473
Netherlands	452	613	651	829
Luxembourg	315	300	1 092	1 764
Germany	245	172	210	403
France	117	67	152	330
Spain			86	283
Total ¹	1 937	1 930	3 669	6 576

1. Including other European countries.
Source: JETRO.

With a view to improving competitiveness of European industry, the European Economic Community is seeking to promote industrial innovation via its research programmes on information technologies (ESPRIT), telecommunications (RACE), the introduction of leading-edge technologies in traditional industries, advanced materials and biotechnologies. Advances in these technologies will facilitate the expansion of services within the EEC. These efforts may have the effect of not only stimulating intra-Community investment, but also investment by the Community in the United States and Japan, and vice versa.

2. INTERNATIONAL DIRECT INVESTMENT IN DEVELOPING COUNTRIES

Direct investment in the developing countries is of particular importance at a time when many of these countries are experiencing financial difficulties as a result of their heavy external indebtedness or when they are attentive of the implications for international direct investment flows to their countries as a result of various other developments including, for example, changing policy regimes for such investment or the effects of advanced technolo-

gies. Increasingly, many developing countries are taking a different and more positive view of the role that international direct investment can play in their development.

This section considers these trends and issues, focusing first (in Part A) on the main features of recent trends in international direct investment in the developing countries as a whole and the broad determinants of these patterns. Part B then examines in more detail the geographical and sectoral pattern of investment flows to three groups of developing countries: Latin America and the Caribbean, Africa and the South-East Asian countries.

A. Recent trends in international direct investment in developing countries

A number of important changes have taken place in the patterns of international direct investment in developing countries since the beginning of the eighties. Principle among these are the changing share of total international direct investment going to the developing countries, changes in the distribution of international direct investment between the main developing country regions, and changes in the position of international direct investment vis-à-vis total private financial flows to the developing countries. The growing share of services in total international direct investment in developing countries is also of note.

In the 1975-79 period, the developing countries as a whole, maintained their ability to attract international direct investment, and the flow of international direct investment to these countries at that time was more sharply upwards than for the OECD countries on average. The reverse situation is found since the beginning of the eighties, when international direct investment by the OECD countries has been expanding, but that going to the developing countries has been slowing down, although it did pick up again in 1986 (see Annex Table A13). International direct investment in the developing countries has remained fairly steady despite a fall in 1985, at averaging around \$10-11 billion per annum, which is well below its level at the beginning of the eighties which stood at \$17 billion in 1981.

The decline in foreign investment in the developing countries has not affected all of them to the same degree: direct investment flows are channelled primarily to countries that are well-endowed with natural resources, to those that offer a vast local and regional market and to those that possess a skilled and low-cost labour force. Thus, over the period 1980-86, 18 developing countries received 86 per cent of international direct investment. They were, for Africa, Egypt, Nigeria, Oman and Tunisia; for Latin America and the Caribbean, Argentina, Brazil, Chile, Colombia, Mexico, Trinidad and Tobago, Venezuela; and for Asia, China, Hong Kong, Indonesia, Malaysia, Singapore, Taiwan and Thailand.

Within this shift in the distribution of international direct investment flows between OECD and developing countries, there has also been a shift in the eighties in respect of the relative attractiveness of different developing countries to international direct investment. The role of the Latin American countries as host countries for international direct investment has declined, primarily on account of the debt crisis and the problems to which it has given rise, and the share of the African countries is still small, while international direct investment in the newly-industrialising, high-income South-East Asian countries is rising, at the expense of other less industrially developed regions.

Total private resource flows to the developing countries have fallen dramatically over the period 1980-86, from \$66 to \$26 billion. While the share of international direct investment in these flows has increased over this period, from 8.7 per cent in 1980 to 14.2 per cent in 1986, this relative increase is not due to any upsurge in international direct investment, which as noted above has remained relatively flat over the period, but rather to the very significant drop in other private flows, particularly bank lending. In 1980 these

accounted for over a third of the total flows in comparison to a mere 6 per cent in 1986 (see Annex Table A13). The main reason for the latter is of course the serious and persistent external indebtedness of a number of major developing countries.

The share of services in foreign direct investment in the developing countries has increased considerably as compared with manufacturing investment. The bulk of this investment has been in banking, insurance, advertising, information and engineering consultancy. The multinationals that have invested in these sectors have done so primarily in order to be close to their customers. Among the host countries, 29 developing countries account for 75 per cent of the stock of investment in services. In many countries the share of services in inward investment exceeds 40 per cent. In 1985, 50 per cent of US investment in the developing countries was in services; the respective share for Germany, Japan and the Netherlands being 40 per cent.

In this connection, it should be noted that these figures are heavily influenced by investment in countries with offshore banking centres (Bahamas, Bermuda, Cayman Islands, the Netherlands Antilles, Panama) and by investment in countries offering flags of convenience. These countries received 70 per cent of investment in services in the developing countries by the United States and Japan between 1977 and 1985, and this was not an isolated case. It seems that direct investment in services in developing countries is channelled primarily to those countries with offshore banking centres or offering flags of convenience. For countries that do not provide such facilities, the share of services in the direct investment that they receive has fallen¹².

The changes in the pattern of international direct investment summarised above can be traced to the effects of a number of forces. Principal among these is the general economic situation in both home and host countries, where in the case of the latter, the debt situation has had a major influence. In addition, a significant role must also be given to technological developments and changes in the market situation for goods and services and the general economic climate and policy environment in developing countries for direct private investment (both by domestic as well as multinational enterprises). The following paragraphs address these determinants.

The particularly favourable growth period in developing countries ended with the world recession of the early eighties. The recession had profound consequences for a number of developing economies which had built up their external debt position to imprudent levels, partly to finance ambitious industrial policies in line with the "unbundling" approaches towards international direct investment, or to finance natural resource investments that often provided lower-than-anticipated returns. In view of the debt-servicing burdens they have had to assume, the economic growth of these countries did not improve with the economic recovery in industrial countries and is now expected to remain severely constrained for the next few years.

High levels of external indebtedness have, of course, underlined the need to encourage as much capital inflow as possible and, in particular, stable flows of productive equity funds. At the same time, international lending, whose volume had come to overwhelm that of direct investment to developing countries, has become much more scarce, as the banking sector in developed countries has moved to limit its exposure. Furthermore, the contrasts between successful experiences with inward direct investment projects and more negative experiences with other, overambitious and costly industrial projects that were geared to assumptions about productivity or demand prospects that proved to be incorrect have become more and more striking. In this harsh new setting, developing countries as discussed later in this section, have generally come to a much more positive assessment of the role of the international direct investment package.

Notwithstanding this more receptive attitude, international direct investment flows to the developing countries have considerably decreased since 1982, and the more so in countries where such flows would seem to be most needed. This apparent contradiction should come as no surprise, however, as inward direct investment was on the increase in developing countries in the 1970s despite more restrictive policies on their part during that period. It underlines that the main determinants of international direct investment are the basic, medium- and long-term economic opportunities in host countries' resources, cost structures and growth prospects – and it is essentially the change in this latter element that constitutes the main explanation of the contraction since 1982. This explains why one of the factors underlining the decline in international direct investment in the developing countries has been that firms in the OECD countries have focused on strengthening their competitive position in their home markets and in the markets of the OECD area, hence the concentration and shift in direction of international direct investment.

For the heavily indebted countries, the magnitudes involved – direct investment inflows for the fifteen most heavily-indebted developing countries amount to less than \$5 billion per year, while their annual debt service exceeds \$50 billion – show that the capital inflows that could be involved in an increase of foreign direct investment can have no more than a limited effect in improving the balance of payments situation of heavily-indebted countries. The balance-of-payments gains of successful international direct investment operations, especially if the latter are export-oriented, may go well beyond the initial capital inflow; but these additional gains are likely to accrue only in the longer run, as part of the initial capital inflow is often spent on imports of equipment. As a consequence, other approaches, such as the rescheduling of debt, need to be pursued in parallel. But it is also unlikely that any single approach will prove by itself sufficient to bring the debt of developing countries to reasonable levels. The contribution that could be brought by increased international direct investment flows would be particularly welcome in view of the beneficial, long-term effects they are expected to have on the productive potential, restructuring requirements and the balance of payments of host countries.

An additional factor which seems to have started recently to decrease the attractiveness of parts of the developing world to foreign direct investment is the development in the late seventies and the early eighties of a number of major technological changes. These have begun to have a major impact on production structures, mostly in OECD countries. The basic technological innovations were undoubtedly available earlier, but the slow growth of demand and the cost-competition context of the mid and late seventies seem to have been particularly favourable to their wider implementation. Many of these innovations – e.g., robotics – are mostly labour-saving and thus tend to reduce the attraction of investment in low labour-cost countries, particularly developing countries. Other developments, such as those in the computer and communications area, could be more neutral as to their labour impact – with the exception of the services activities – and could, in certain cases, favour decentralisation of production and thereby increase the chances of developing countries. However, they require the availability of a skilled labour force that can be found only in the developed countries, or in the newly industrialising economies (NIEs) which also have low labour costs. Developments in the area of new materials, raw material-saving, and energy-saving techniques could have the effect of pushing further to the future a significant revival of mineral resources industries that would represent one of the very few opportunities for some developing countries – notably in Sub-Saharan Africa.

It is difficult to gauge the scale on which growth in industrial activities is shifting back to the OECD area or concentrating in NIEs as a result of the technological changes described above, and especially to estimate how long the process will continue. Of course,

comparable shifts have sometimes developed, at least to some extent, in the past, under the influence of previous waves of technological innovation. During the late 1950s for example, a number of textile companies sought to rationalise their activities in order to keep from moving production to developing countries, but they were ultimately defeated by competitors choosing to follow that strategy instead of trying to resist it. Because they are so wide-ranging, the effects of the present technological wave could appear to be both more powerful and longer-lasting than those involved in earlier periods. Far from being confined to any particular activity, they seem to be in the course of reshaping a wide range of industries. If this assessment proves well-founded, the capacity of very broad regions of the developing world to attract international direct investment could prove to be further and more permanently reduced. In the longer term, the countries concerned could be altogether cut off from the development of a new technological culture. This could ultimately leave them in a weak position to take advantage of the eventual resumption of more favourable trends, and even less prepared to face the consequences of yet newer generations of technology appearing on the horizon¹³.

The policy environment in developing countries, with respect to both domestic and foreign investment is both a key factor in the ability of developing countries to attract and hold international direct investment and also one that has been changing since the early eighties. In the 1970s, foreign investment regimes were generally restrictive although there were exceptions and variations between countries. A few developing countries practised very liberal investment regimes throughout the seventies. Among these are some of the present-day NIEs. In other NIEs liberal conditions for foreign investors were confined to particular sectors in particular periods, in line with well-developed industrial policies. International direct investment continued to take place even in some of the most restrictive countries, often in cases where the conditions imposed on them were transparent and kept stable. Many enterprises engaged in new form of investment, which, although not generally their preferred form of investment, had the advantage of reducing their commitments in a period of rising uncertainties.

A few policy-makers in developing countries have always been convinced of the benefits of foreign direct investment for development: such investment constitutes a tightly bound package of capital inflows (with associated outflows being more closely tied to the profitability of the operation), of technologies that are often new to the host country, and of managerial and marketing services that are locally in short supply. Furthermore, the experience with the technologies and services capabilities of the foreign enterprise that is gained by its local work force and its local suppliers and clients is likely to be transmitted to some extent to the rest of the economy. Developing country critics of foreign direct investment have, on the contrary, stressed that a significant proportion of the capital inflow involved is likely to be spent on imported equipment or other inputs, and that the transfer of profits abroad tends to be excessive. In their view, multinational enterprises have a bias for imported rather than local supplies, while the experience gained with new technologies is minor, or inaccessible to local firms because of the gap between imported technologies and those that can develop locally at any significant scale. More generally, multinational enterprises are seen, in this view, as being in a position to extract, notably through their pricing policies, most of the advantages from the situations in which they are involved, with few of these advantages accruing to host countries. The detailed analyses and assessments of the impact of foreign direct investment generally underline its long-term contribution to the efficiency and the development of the host economies, and they do point, with some exceptions, to positive overall effects. But they are too dated, too variable in their formats and approaches, or too narrowly focused to convince the critics or to persuade them to put

into perspective their concerns as to the risks that important foreign direct investment may imply for the economic independence of their countries¹⁴.

As a consequence of such negative perceptions, the foreign investment regimes of many if not most developing countries have always included strong restrictive elements. Entire sectors, often among the most interesting ones for foreign investors, have been completely closed and, in the early 1970s, a nationalisation wave developed, in particular in the natural resources sectors. In other cases, in particular when the technologies available to a few multinational enterprises could not be foregone, conditions have been imposed with the aim of increasing the share of the host country advantages derived from foreign investment operations, often to the detriment of the viability of these operations or discouraging them altogether. Among these conditions are significant trade-related investment measures, that are much more widespread than in OECD Member countries.

Investment incentives were sometimes provided to encourage multinational enterprises to go along with these approaches and to compensate partly for the effects of some of the conditions imposed on them, as well as for some of the general difficulties of doing business in certain areas of the developing world (lack of adequate infrastructure, low level of public and administrative services, and other costs resulting from red tape and/or inadequate legal infrastructure, etc.). While those measures were often of a financial or fiscal nature, in a considerable number of cases they took the form of trade measures protecting the local production of the investing foreign enterprise from competition by imports or by subsequent investments. The risk that the resulting investments would not be viable internationally in the absence of continued support is evident.

While many developing countries still maintain often important restrictive measures concerning international direct investment, their policy approach in the eighties, in clear comparison to that of the seventies, is much less restrictive. More and more developing countries – even those in which inward direct investment was formerly forbidden, or, for all practical purposes, impossible – now actively seek to attract foreign investors and many have relaxed their foreign investment regimes. Some still retain interventionist legislation, but grant more and more authorizations, in an increasing number of sectors, and forego many conditions that they tended to enforce strictly in the past.

It is also true that in certain developing countries a number of major restrictions continue to prevent or impede inward direct investment. In Brazil, for example, despite the poor domestic situation, there are restrictions on investment in sectors such as that of advanced technology. In Mexico, compulsory local content requirements continue to be set. Furthermore, although several heavily-indebted countries have taken measures to facilitate the inflow of foreign capital, they still restrict, or are taking measures to restrict or to prevent, the repatriation of capital or earnings by foreign firms. Such measures are major impediments to foreign investment¹⁵. Also, the need to meet high debt service payments has led some host countries to take emergency measures that restrict access to foreign exchange or imports and thereby impede the efficiency of established foreign firms and discourage new entrants. More generally, the debt crisis has led to measures and situations rendering day-to-day business activity more difficult in the countries most affected, and this has had an impact on foreign investors as well. But it is striking that the sometimes significant liberalisation of investment regimes has not produced the hoped-for results in highly indebted countries; nor in most of the poorer countries which are simply unable to offer the opportunities which could attract international investment on any significant scale.

The external environment for most developing countries is now even less favourable than it has been so far during the 1980s. The distinctly counter-productive results of many developing countries' previous domestic policies (policies towards saving and investment,

public finance and monetary policies) are by now all too evident and the fact is increasingly being recognised by developing countries' governments themselves. This should lead, through the implementation of successful structural adjustment programmes, to an improvement in the general climate for business, a feature considered by multinational enterprises as an essential prerequisite for investment. Also encouraging is the change in attitude towards foreign investment itself which is increasingly seen as making a positive contribution in the context of more market-oriented domestic policies.

The present situation shows that there is room for new approaches to encourage more foreign direct investment and one approach which has been discussed a great deal recently is that of the debt/equity conversion schemes recently put in place by a number of developing countries¹⁶. Such schemes, which are sometimes associated with local privatization programmes, seem to represent a step in the right direction. Obviously some experimentation will be necessary before ensuring that the modalities of these schemes are in the optimal range. Furthermore, the recent evolution of secondary market prices for developing country debt may act as a negative factor. Also worth noting are the efforts made to develop stock markets in some developing countries¹⁷ and the renewed interest in approaches such as that of build-own-transfer (BOT) franchising operations.

The Multilateral Investment Guarantee Agency (MIGA) should contribute in important ways to foreign direct investment in developing countries through its insurance mechanism, and some additional investment is expected to result from this. The promotional activities through which MIGA should advise developing countries on the creation of favourable conditions for foreign investors and, in particular, on those conditions required for the insurance mechanism to be applicable, may prove of equal importance, as these conditions should affect a broad range of foreign investors beyond those seeking insurance.

Foreign direct investment decisions are and should remain the responsibility of corporate investors. The role of OECD governments, be it through their influence on world economic growth or otherwise, is therefore an indirect one. Encouragement is being provided by a number of OECD Member countries for investment in developing countries, mostly but not exclusively through the support of national investment guarantee schemes (tax credits, soft loans, and grants for feasibility studies are sometimes involved). At least some countries feel that a significant increase in, or a broadening of, such assistance is generally not envisaged favourably, as it would deviate too much from the principle of neutrality. Among the possible additional approaches that may be offered is that of promoting a better utilisation of Official Development Assistance flows, aimed at improving the general conditions for doing business and the conditions in which foreign investors are to operate.

As mentioned above, recent technological changes may affect the ability of developing countries to attract foreign direct investment – essentially positively for NIEs and clearly negatively for most other developing countries. Encouraging direct investment in the latter, so as to avoid the development of a further technological gap, undoubtedly involves supporting appropriate host countries' policies regarding education, training and technological transfers. It also raises important issues related to better protection of intellectual property rights. Another question is that of the policy role of the NIEs in view of their recently-acquired position, and, inter alia, of the possible assistance that they could provide, in view of their own recent experience in industrial take-off.

Export-oriented direct investment can play a particularly important role in reducing the burden of heavily-indebted countries, as it is less dependent on local demand conditions which are expected to remain somewhat depressed. OECD Member countries have, in this respect, the important responsibility of facilitating access to their markets for the corre-

sponding imports without which such investments will not take place. The sensitivity of international investors to potential risks in this respect is easily understandable, as they have to commit themselves to particular operations for relatively long time periods. Dispelling such risks and building the confidence of investors is an important task for international economic co-operation in the years ahead.

B. Geographical and sectoral patterns of flows

Latin America and the Caribbean

Latin America traditionally accounted for over half of the total international direct investment going to the developing countries, but for the period 1981-86, its share fell to around 48 per cent, in comparison to around 52 per cent for 1976-80. As seen from Table 21 below, investment flows to the region have remained fairly flat since 1981, averaging between \$5 to 6 billion per annum except for a sharp fall in 1983 to just over \$3 billion.

As seen from Table 21, it has been the major countries of the region, Brazil, Argentina and particularly Mexico which have fared worst. For example, in 1986 Brazil achieved only 15 per cent of its 1981 level of inward investment, the comparable figure for Argentina being 49 per cent. Mexico, in three of the six years in the period 1981-86 experienced net disinvestment. As a result, these three countries which accounted for 46 per cent of flows to Latin America in the period 1976-80 attracted only 25 per cent of them in the 1981-86 period.

United States companies have traditionally been major investors in Latin America and while this is still true, the relative importance of their investment in this area has certainly fallen off considerably since the beginning of the 1980s. For example, and on the basis of stock data, Latin America accounted for 18 per cent of United States worldwide stock of outward investment in 1981, but this had dropped to 13 per cent by 1986. Despite this decline in the relative importance of Latin America as a destination for United States investment, international direct investment by United States firms in Brazil (on the basis of stock data) has grown steadily, but slowly over the period, from \$5.4 billion in 1981 to \$6.5 billion in 1984 with the 1985 level being \$7.1 billion¹⁸. The situation for Mexico is relatively similar, although 1984 and 1985 levels of the stock of United States investment,

Table 21. International direct investment in Latin America by DAC countries, 1976-1983¹

US\$ million

	Cumulative flows				Annual flows					
	1976/80	% ²	1981/86	% ²	1981	1982	1983	1984	1985	1986
Latin America	27 872.2	51.6	32 641.9	47.8	6 234.9	5 897.9	3 817.3	5 899.1	5 057.1	5 735.5
Mexico	3 740.9		751.8		1 225.7	-1 038.5	-325.5	580.2	359.4	-49.5
Argentina	2 370.1		1 653.2		580.1	378.9	104.7	134.6	171.5	283.4
Brazil	6 717.1		5 855.5		1 348.5	1 609.8	674.0	1 478.5	549.2	195.5
Total developing countries	53 974.4		68 240.4		16 850.8	12 358.2	9 127.4	11 332.1	6 527.3	12 044.6

1. Some data include reinvested earnings, others do not, and some also include oil.

2. Share of the total developing countries.

Source: OECD.

for both years at around \$4 billion, has not yet surpassed the 1981 level of \$5.2 billion. By comparison, there has been a relative growth in investment by Japanese, British and German firms, though much of this has been channelled to Panamanian and Caribbean offshore banking centres. Data on the stock of German direct investment show a picture, for Brazil, similar to that for the United States, i.e., steady but slow growth of the stock of German investment, from DM 5.5 billions in 1978 to DM 6.9 billion in 1981 and DM 7.4 billion in 1983 (the last year for which statistics are currently available). The stock of German investment in Mexico reached a peak of DM 1.6 billion in 1981, since then it has fallen off markedly, the 1983 level being DM 896 million.

The deterioration of the international direct investment situation in Latin America, and particularly in Mexico, Brazil and Argentina, is of course very closely related to the fact that they have been confronted, to a much greater extent than other major developing countries, with the problem of servicing and rescheduling their external debt. Severe external disequilibria, depressed domestic demand, wide swings in real exchange rates and high domestic inflation have all contributed to a climate that is much less conducive to international direct investment. Associated with these features, restrictions on imports and repatriations as well as other measures with restrictive effects on international direct investment have meant that investors are still very much concerned about the conditions of investment in the area. They also note that the rate of return on investment in the area, as seen from Table 22 below, now compares unfavourably with that in other developing countries or in the industrialised countries. All in all, the economic situation is therefore potentially very discouraging to investors.

At the sectoral level it is difficult to generalise, but industrial output has begun to pick up since 1984, rising by about 6 per cent in 1986. Since 1984 manufacturing and services have spearheaded restructuring in Latin America. The only exception is Mexico, where domestic demand contracted in 1986, as a result of which industrial demand fell by about 5.5 per cent; all industries, apart from petrochemicals, were affected, and particularly the automobile industry. Brazil experienced three consecutive years of steady industrial growth,

Table 22. Rate of return on US outward investment by industrial sector

	Percentage					
	1980	1981	1982	1983	1984	1985
Industrialised countries	16.5	11.7	8.0	9.0	9.0	16.2
Oil industry	26.5	20.3	12.9	14.8	16.8	16.2
Manufacturing	12.4	8.1	5.9	7.5	6.3	17.8
Other	15.7	10.9	7.4	7.1	7.2	14.1
Latin America	18.8	15.8	7.6	2.4	5.4	10.0
Oil industry	23.0	23.0	17.1	9.7	0.2	8.3
Manufacturing	15.8	11.5	1.6	-1.4	6.6	10.1
Other	20.0	17.4	10.4	3.3	10.3	11.0
Other developing countries	41.3	40.9	29.9	22.5	23.8	18.6
Oil industry	79.7	65.3	42.6	26.1	28.5	21.2
Manufacturing	18.3	18.2	12.8	18.4	20.1	17.6
Other	24.2	25.9	22.9	19.7	18.7	15.2

Source: UNCTC Trends and prospects 1988; US Survey of Current Business, various issues.

the rate reaching 11 per cent in 1986. This was made possible by the excess capacity that was available in many industries, and particularly in the electrical industry, on account of the massive investment that had been undertaken prior to the start of the financial crisis. The entire increase in industrial output was absorbed by the domestic market after substantial wage increases had been awarded. It seems, however, that the remaining slack will not be taken up. Argentina also experienced renewed growth in 1986, with industrial output up by 12.8 per cent after rising by 10.5 per cent in 1985. This expansion was made possible by growth in domestic demand and by production for the external market. The installed industrial capacity available allows an increase in output to be envisaged. Similar growth took place in Chile, Colombia, Peru, Uruguay and Venezuela.

In all these countries there was little investment in new plant and equipment; most investment was carried out to replace or to modernise existing plant, except in Colombia where there was substantial investment, especially in the mining sector. Other countries in the region (for example those in Central America and the Caribbean), with smaller markets, continue to be burdened by chronic over-capacity; the plants in these countries were designed to produce for the regional market, and local markets are incapable of absorbing all their output¹⁹. In respect of the Caribbean countries, it may be noted at this point that, to improve international direct investment in the Caribbean basin, the United States initiated a few years ago the "Caribbean Basin Initiative" to help encourage new United States investment in this zone.

Many of the large, capital-intensive and export-oriented industries of Latin America, such as mining, need to be restructured if they are to be competitive in foreign markets. In South-East Asia, the introduction of new technologies in the textile, clothing, electronics and automobile industries has allowed these industries to be restructured. Companies in Latin America will have to invest on a large scale in equipment and technology if they are not to go under. The survival of these industries will depend on their ability to become competitive vis-à-vis both the industrialised countries and the newly industrialising economies of South-East Asia. To do so will require considerable investment to increase capacity and to create new products. But the Latin American countries' external deficit and the lack of private investment may severely curtail their ability to restructure and to expand their production capacity, especially in industries that use new technologies to design complex products. The scientific and technological infrastructures that Latin America needs to expand are still weak; adjustments and innovations are required to achieve an optimal capital-labour-new technology mix via various forms of international direct investment.

For the reasons given above in Section A of this chapter, international direct investment can make an important contribution, both short run as well as long run, to the efforts of the countries of this region to resolving their serious economic difficulties. But, at the same time, it is the economic situation and related policy regimes for international direct investment that have in fact depressed international direct investment flows to the area. Clearly, headway will have to be made on a number of fronts before significantly higher levels of international direct investment will be forthcoming.

On the policy side, there have been a number of developments which investors have viewed positively such as, for example, the now less restrictive Andean Pact regime for direct investment. Investors have certainly welcomed those relaxations that have taken place. Similarly, privatisation efforts may open up a number of areas for investment as long as these are accessible to foreign investors on acceptable terms and conditions. Nevertheless, controls and restrictions on international direct investment are still widespread in many countries; not only have many such measures been maintained in the face of deteriorating circumstances, but new ones have also been introduced. The danger is, however, that such

measures, including trade-related investment measures and other measures with similar effects, which may have been accepted by some investors in the past may now bite much harder into the viability of projects or may be seen even more negatively than before as indicative of the climate for and attitudes towards international direct investment. The relaxations which have taken place in some countries and for certain activities do suggest that some countries are attempting to strike a new balance in their policy stance to equate their desire to obtain more investment with political and economic pressures, but it is also clear that investors will wish to see further such moves before the countries of this region can regain their previous attractiveness to international investors.

Africa

Africa receives a relatively small amount of international direct investment. Since 1976, it has, on average, received only around 10 per cent of total outward investment flows from Development Assistance Committee (DAC) countries to developing countries. In fact, and as seen from Table 23 below, its situation significantly deteriorated after 1982; for the period 1983-86, Africa received only 5 per cent of total flows. The main reasons behind this bleak picture are of course the lack of local markets, and a trained labour force, as well as poor infrastructure. To this can be added the stagnation of demand for raw materials and increasingly, the growth of external indebtedness of the region.

As in the other developing country regions, direct investment flows to Africa are concentrated on a relatively small number of countries, most of which are oil exporters. Thus, over the period 1981-1985, Algeria, Cameroon, Nigeria and Tunisia accounted for 90 per cent of foreign investment in Africa. Higher crude oil prices and the entry into the market of new oil-exporting countries gave a boost to oil prospecting in Africa and thereby to investment; since then, however, the flow of investment has dried up. For example, United States international direct investment in Africa, by the end of the seventies, amounted to around \$5 billion, of which South Africa received \$2 billion. In 1986 and 1987, there was net disinvestment by United States companies in South Africa, but on the other hand, official incentives to invest in the rest of Africa are growing. This is not to say that investment trends will be reversed and that United States companies will invest more in Sub-Saharan Africa. Apart from South Africa, United States companies had invest \$400 million in Nigeria by the end of the seventies, particularly in banking and oil but the

Table 23. Foreign direct investment in developing countries by DAC countries¹

	US\$ million									
	Cumulative flows				Annual flows					
	1976/80	% ²	1981/86	% ²	1981	1982	1983	1984	1985	1986
Africa	5 932.1	11.0	6 515.9	9.5	1 983.0	2 447.6	978.4	25.4	630.2	451.3
North Sahara	1 188.5		1 822.9		152.6	160.4	605.8	249.1	789.6	-134.6
South Sahara	3 177.6		4 614.9		1 808.9	2 239.4	337.1	-228.9	-64.7	543.10
Total developing countries	53 974.4		68 240.4		16 850.8	12 358.2	9 127.4	11 322.1	6 527.3	12 044.6

1. Some figures include reinvested earnings, others do not, and some also include oil.

2. Share of the total developing countries.

Source: OECD.

Table 24. Sub-Saharan Africa: external debt

US\$ billion					
1980	1981	1982	1983	1984	1985
103.2	112.2	119.9	130.4	133.0	143.7

Source: World Bank.

slowdown of the oil industry in Nigeria in 1985 and 1986 has limited their interest in Nigeria. More generally, it can be said that the economic situation in Africa is not encouraging for foreign investors.

The situation of Sub-Saharan Africa is still critical, and an increasing debt burden (see Table 24) and the collapse of commodity prices coupled with the drying up of investment flows are impeding efforts to improve it. Further, the reforms and structural adjustment measures implemented have often been costly. Many countries have pushed through reforms to increase their financial resources – for example, measures to assist the private sector such as liberalisation of markets and investment.

Concerted approaches are being developed to promote economic recovery in Africa. For example, the Economic Community of West African States has announced its intention to launch a joint plan of action. The countries of southern Africa are developing trade, financial, industrial and energy ties with the object of making their economies less dependent on South Africa²⁰.

The nine member countries of the SADCC (Southern African Development Co-ordination Conference) are seeking to promote conditions conducive to investment, despite the fact that their external debt rose from \$13 billion in 1984 to nearly \$15 billion in 1985. In January 1988 the Nordic Group (comprising Sweden, Norway, Finland and Denmark) announced that its total ODA to the region would attain \$1 billion, and that it was setting up a NORSAD fund of US\$32 million to assist the creation of joint ventures in the region²¹. The United States Overseas Private Investment Corporation, with a view to encouraging privatisation in African countries, intends to create a fund of \$30 million. Also, bilateral creditors have proposed measures to reschedule the region's debt and to reduce interest rates. Canada, for example, has cancelled the debt of seven African countries and the Netherlands has exempted a number of African countries from debt service payments in 1986-87 to the amount of 62 million guilders. As well as the schemes to recycle funds totalling more than \$30 billion, Japan will increase its assistance to impoverished and debt-burdened Sub-Saharan Africa and least developed countries (LDCs) in other regions. Japan will assist these countries, including the provision of non-project grants worth approximately \$500 million over the next three years to help in such areas as structural adjustment.

As regards industry, the improvement in mining and industrial production recorded in 1984 did not continue at the same rate in 1985 and 1986. The slowdown in demand in the industrialised countries resulted in a slowdown in demand for raw materials. Although it rose slightly, industrial output felt the effects of supply bottlenecks and the flatness of world demand. African ore production was hit by both these factors, with the result that uranium, phosphate, iron ore, cobalt, bauxite, copper and natural diamond prices fell. Nonetheless, in the mining sector investment is required for modernising and expanding mines and for prospecting, thereby providing opportunities for foreign investors.

1985 was the first year of implementation of the Programme for the Industrial Development Decade for Africa, in the course of which a number of projects are to be implemented to speed up the rate of growth of industrial output. During the period 1980-1984, the manufacturing sector grew by 1.5 per cent a year, and at only a slightly higher rate in 1985 and 1986. In countries like Senegal and Zimbabwe, industrial output picked up in 1985. Good harvests enabled the agro-food industries to increase their output in the Ivory Coast and Zimbabwe. Textile output rose in Tanzania, Malawi, Mozambique and Zimbabwe. The tobacco industry expanded in Zambia and Malawi. Sugar production rose in Nigeria and Mozambique, while paper production increased in Kenya, Nigeria and Tanzania²².

On the other hand, several countries continued to be hit by the recession in their manufacturing sector – which was due mainly to the shortage of raw materials, spare parts, fuel and transport facilities – as a result of which production capacity was largely under-utilised. Many countries embarked on programmes aimed at modernising their industrial sectors: the Ivory Coast and Mozambique in the sugar industry, Ghana in the textile industry and Zambia in the brewing industry. These programmes offer investment opportunities for foreign investors, provided that the African countries are able to find the finance for them.

Nonetheless, the volume of direct investment in Africa remains fairly small. For middle-income countries like the Ivory Coast, Morocco and Zambia, annual direct investment flows range between \$50 and \$100 million. For low-income countries, the amount of direct investment is very small – a few million dollars. Ill-endowed with natural resources, lacking a large domestic market and a well-trained labour force, these countries are relatively unattractive to foreign investors. Also, many Sub-Saharan countries are recording negative growth and investment rates, largely on account of the collapse of commodity prices.

South-East Asia

Asia's share of total international direct investment flows to the developing countries has increased substantially, from 21.5 per cent in 1976-80 to 29.8 per cent for 1981-86. This change is due, in part to the declining share of international direct investment received by other regions, particularly Central and Southern America, but also to Asia's own ability to attract higher levels of inward investment. The annual average flow for the period 1981-86 was \$3.4 billion, in comparison to \$2.3 billion for 1976-80. Nevertheless, and as seen from Table 25, annual inflows dropped significantly after 1981 and particularly in 1985. Although inflows have picked up again in 1986, they are still well below the 1981 peak.

As in Latin America, international direct investment flows to Asia are concentrated in a small number of countries: Hong Kong, Indonesia, Malaysia, Korea, Singapore, Taiwan and Thailand, plus the special case of China. These countries received over 90 per cent of foreign investment in Asia between 1981 and 1985. In fact, foreign investment accounted for over 50 per cent of total resources in Hong Kong, 73 per cent in Singapore and 62 per cent in Taiwan, against only 10 per cent in Malaysia and 12 per cent in Thailand.

The above noted resumption in 1986 of international direct investment flows occurred as some countries, e.g. Malaysia, introduced liberalisation measures, commodity prices recovered and currency realignments restored to these countries competitive advantages that made them once again an attractive destination for international direct investment that was mainly directed towards stepping up exports: this has resulted in higher exports of

Table 25. Foreign direct investment in developing countries by DAC countries¹

US\$ million

	Cumulative flows				Annual flows					
	1976/80	% ²	1981/86	% ²	1981	1982	1983	1984	1985	1986
Asia	11 622.3	21.5	20 336.6	29.8	6 504.8	2 459.0	3 412.4	4 731.2	694.2	2 535.0
Hong Kong	1 247.3		3 685.3		1 087.8	651.8	603.0	696.4	-134.5	778.7
Indonesia	1 015.4		3 096.3		2 583.5	537.4	302.7	494.6	311.3	-506.6
Korea	88.2		1 062.2		260.6	107.3	-62.4	246.2	168.1	362.4
Singapore	1 304.3		3 484.2		979.5	280.4	417.8	889.6	327.3	589.6
Taiwan	294.1		885.4		118.9	57.1	120.1	208.1	109.7	271.5
Thailand	355.0		767.7		219.3	127.9	200.1	348.3	-96.9	-31.0
Philippines	871.0		71.3		114.4	125.6	-168.2	167.1	-248.9	81.3
Total developing countries	53 970.4		68 240.4		16 350.8	12 358.2	9 127.4	11 332.1	6 527.3	12 044.6

1. Some data include reinvested earnings, others do not, and some also include oil.

2. Share of the grand total.

Source: OECD.

energy products from Thailand and Malaysia, heavy industry by-products from Malaysia, high technology products from Malaysia, Singapore and Taiwan, and financial and computer services from Singapore. South-East Asia has a number of features that make it attractive to international direct investment. For instance, Indonesia and Thailand have large domestic markets; Hong Kong, Malaysia, Singapore and Taiwan have large, cheap and well-trained industrial workforces; Malaysia and Indonesia are also well-endowed with natural resources such as oil, tin, etc.

The attitude of Asian countries towards international direct investment is also changing. After the deterioration in their trade balance as a result of the fall in commodity prices – especially that of oil – and the increase in their external debt, some Asian countries have modified their attitude to foreign investment and have started to open up their economies to foreign capital. Countries such as Hong Kong and Singapore have become even more liberal while liberalisation in Taiwan has made matters much easier for foreign investors. However, unlike the long-established free-market countries in the region, India, South Korea and Sri Lanka have maintained restrictions on international direct investment until only recently (1977 in the case of Sri Lanka, 1984 in the case of South Korea)²³. By comparison, in South Korea the government has introduced a policy liberalising the entry of foreign capital. In October 1985 it announced the opening up of several sectors to foreign investment. The Singapore government has introduced a package of new policies to revitalise the economy and to make it easier for foreign firms to set up in the country; for example, if a foreign firm establishes its head office in Singapore, the rate of tax on its profits can be reduced to 10 per cent. Special tax relief, too, is offered to firms in leading-edge sectors such as biotechnology, engineering and financial services; and Thailand is also implementing more flexible policies towards foreign investors.

The newly industrialising economies have introduced new economic policies that recognise the role to be played by direct investment in technology transfers. The areas of investment are changing, indicating industrial restructuring similar to that experienced by Japan. The weight of the non-manufacturing sector is tending to increase, especially in the

newly industrialising economies; the manufacturing sector is undergoing a change that will tend to strengthen advanced-technology sectors such as information technology, electronics and biotechnology.

As a result of the new policies implemented by the newly industrialising economies, the attitudes of foreign investors have also changed. Since 1985 the yen rise has helped to increase the share of Japanese investment in total foreign direct investment in the Asian countries. The stronger yen particularly affected Japanese exporters after the second half of 1985. Nonetheless, by increasing the overseas purchasing power of Japanese firms, it contributed to a substantial increase in direct investment. Asian countries are now considered by Japanese investors to offer the most attractive locations for new plants, and this view is shared by US firms who have at the same time benefited from the advantages offered by the newly industrialising economies²⁴.

In Korea, Japanese, US and European direct investment has risen steeply since January 1986. Japanese investment has doubled, accounting for over half of all foreign investment in the country – most of it in the electronics sector – followed by the automobile industry. Ford and Toyo Kogyo have simultaneously invested in a Korean firm, and Ford has also strengthened its production capacity in automotive spare parts. Foreign, and particularly Japanese investment has taken place on a large scale in the information technology, electronics and plastics sectors, and has been welcomed on account of the advanced technology it brings with it. Investment in the cosmetics and ready-to-wear sectors is also starting to expand. In Taiwan, Japanese investment accounts for 42 per cent of foreign investment, up by 26 per cent on 1985. It should also be noted that much of this investment goes to small and medium-sized enterprises, especially manufacturers of electrical equipment and metal products. In 1985 US firms expanded their high value-added production and their R&D activities in Singapore. They also transferred certain labour-intensive activities there. Japanese firms, too, stepped up their offshore investment in Singapore. In Malaysia, Japan is the leading investor, with 25 per cent of total foreign investment, despite a tax reform quadrupling the amount of foreign capital required to start a manufacturing business. Thus, since the beginning of 1986, and in contrast with developments between 1980 and 1985, Japanese investment in Asian countries has risen steeply, while the share of other foreign investors has fallen. These far-reaching changes concern in particular the chemicals, electronics and automobile sectors, as shown by the examples of Singapore and Hong Kong.

China is something of a case apart. Since opening up its economy to foreign investment, it has become one of the major host countries to foreign investment. According to the IMF, between 1980 and 1985 China received 5.8 per cent of investment flows to developing countries, moving into fifth place behind Malaysia (8.9 per cent), Singapore (9.5 per cent), Mexico (10.8 per cent) and Brazil (16.7 per cent). Between 1979 and 1987, cumulative investment flows to China amounted to almost \$20 billion, of which nearly \$7 billion had been implemented at 1st January 1987, corresponding to 8 000 contracts, a large proportion of which involved compensatory purchasing deals (\$1.5 billion at 1st January 1987)²⁵.

The number of investments that were authorised in 1985 was particularly high and related to the decision to open up to private investment seventeen coastal towns in addition to the four Special Economic Zones created in 1979, which had attracted a total of \$569 million in investment by 1st January 1987, of which \$127 million had already been realised. It seems that 1985 was a particularly good year for international direct investment in China, with a total of \$6.3 billion, or 40 per cent of the total investment authorised for the period 1979-85. Investment in 1986 is reported to be around \$3 billion, suggesting a relative slowdown in investment.

Table 26. Foreign investment in China, 1986

Percentage	
Hong Kong and Macao	66.0
Japan	11.5
United States	9.5
United Kingdom	2.9
France	2.6
Singapore	1.6
Germany	1.3
Belgium, Italy and the Netherlands	1.0

The type of investment in China is also tending to change: 45 per cent of contracts between 1975 and 1985 related to industrial projects and co-operative agreements for the exploration and development of China's natural resources, principally oil (41 contracts totalling over \$2 billion), the remainder going to tourism projects – hotel construction and taxi firms. The new 1986-1990 five-year plan gives priority to investment in machine tools, electronics, raw materials, light industry and textiles. The Chinese government hopes to attract foreign investors and thereby to make China more internationally competitive; it is for this reason that it gives priority and offers special conditions to investment embodying advanced technology. Thus, in 1986, in contrast with the previous period, 76 per cent of contracts were related to industrial projects in manufacturing, agriculture, transport and telecommunications, worth \$11 billion. The main investors were Hong Kong and Macao, followed by the United States and Japan (see Table 26).

All in all, the situation of Asia in respect of international direct investment is relatively favourable, particularly in comparison to other world regions such as Latin America. Nevertheless, there are still a number of worrisome developments within this general picture. Where international direct investment levels for the industrialised countries have now overtaken their previous peaks at the beginning of the decade, 1986 investment flows to Asia as a whole are still well below their 1981 levels. Thus, while Asia's share of total international direct investment going to the developing countries has increased, its share of world international direct investment has fallen. At the level of individual countries, there has certainly been a resurgence of inward investment since the major fall in 1981 and particularly in 1985, but this has not been the case for all countries, for example in Indonesia, Thailand or the Philippines where international direct investment is still at very low or even negative levels.

As a whole, Asia does not face the same level of difficulty as Latin America in terms of economic growth or external indebtedness but its ability to maintain and improve its attractiveness will depend on many factors including, for example, the extent to which liberalisation of investment regimes will be pursued, the ability of some countries to offset the decline in their comparative advantage due to labour-related factors by other forces, the effect of advanced technologies on the delocalisation of investment and the extent to which other regions, particularly Latin America, improve their economic climate for international direct investment in their countries. In addition, the major developing economies of Asia are increasingly in direct competition (for investment and trade) with OECD countries and will be under increasing pressure to adapt to international disciplines and practices if they are to meet the new challenges thereby posed.

CHAIRMAN'S SUMMARY OF THE DISCUSSION

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This first session of the Round Table discussed recent trends in direct investment to the developing countries and the forces underlying the changing patterns observed. The broad trends are quite clear. Direct investment worldwide has been growing strongly, but most of this has been confined to the industrialised countries, where particularly the US and Europe have achieved much higher levels of inflows. Direct investment in developing countries has been stagnant or declining, so they have been losing out in relative terms, in sharp contrast to the situation up to the early 80s. While there has been a notable rise in the last couple of years, this is not a clear sign of recovery of interest in investing in developing countries once account is taken of financial transactions in offshore banking centres.

So, while there has been some good news in respect of direct investment, much of this has been concentrated in the OECD area. The newly industrialising economies (NIEs) of South East Asia have also been attracting more direct investment but, overall, this has to be seen in the perspective of little improvement in direct investment in manufacturing in the developing countries. Clearly, care must be taken in interpreting statistics on direct investment, but in the end, it seems that the above picture still bears out.

There has also been some good and bad news in the area of policy regimes related to direct investment. In the OECD area, strong economic growth together with an increasingly open investment climate have been the major forces behind the growth of investment. In fact, liberalisation (encompassing privatisation, deregulation and the removal or relaxation of controls and restrictions on direct investment) has played a dual role – stimulating in an interactive way economic growth in general as well as direct investment. But there are also recent and worrisome signs of countertrends to this broad liberalisation, such as the growth of protectionist pressures in the investment area and the use of local content requirements which threaten the achievements so far gained.

It is also apparent from our discussion that there has been a quite evident opening up of developing countries to direct investment. Some countries have traditionally been open, while others have clearly moved in that direction, in some cases because of a certain disenchantment with earlier approaches, in other cases because severe debt problems pushed for relaxation of investment regimes. The result, one way or another, has been a generally more positive view of direct investment, though there are still nuances and difficulties on the part of those involved.

For example, one of the points that was noted concerns the continued restrictions on direct investment in particular sectors such as services. This has often been the result of a wish to develop infant domestic enterprises where it is felt that unimpeded foreign competition would not allow the development of the domestic sector. In other examples, however, countries have modified their views on this matter – and accordingly their policies too – as it

was found that the approach of reserving certain activities to the domestic sector caused a bottleneck which unduly restricted the overall development of the economy.

A further concern addressed by participants was that of the involvement between the foreign investor and the local sector. In some instances, it was felt that foreign investors were reluctant to accept local partners, though it was also stated that local partners in the areas or activities wanted were not always available. It was pointed out that some countries have been relaxing their policies or at least taking a more pragmatic approach to questions of local ownership, but perhaps the point to single out from this discussion is that of the need to develop a strong local sector. Not only would this provide partners for foreign investors, it would also signal a good economic climate and a commitment to private investment in general, be it by domestic or by foreign-controlled enterprises. It was also suggested in this context that developing a strong private sector could promote the return of flight capital.

From the perspective of foreign investors, it was recalled that business welcomed the improved openness towards direct investment. Nevertheless, some specific points were made in respect of areas of concern which make doing business more complex or difficult. Mention was made, in particular, of difficulties with the availability of local inputs and ability to import necessary production goods, restrictions on the mobility of personnel and the need for fiscal regimes which permitted a competitive return on capital. The problem of counterfeiting was also raised as one which is having very serious consequences.

To recall the words of one of the speakers of this session, there has been both good news and bad news, but from our discussion, the feeling is that the good news predominates, at least in the sense that the idea of promoting and liberalising direct investment is now much more shared by all the parties involved. There also seems to be a quite general desire on the part of all to work towards removing or remedying the forces that may restrict or distort investment flows, but it is also clear that there are important differences between the approaches of countries. The discussion of countertrends to liberalisation in the OECD economies emphasises that the industrialised countries are worried about protectionism, wherever it occurs. Efforts are therefore required by all countries, developed and developing, as well as by international organisations to resist such pressures and strengthen commitments if we are not to lose the benefits of an open and increasingly interdependent economic system.

The discussion provided all participants with something to think about and some ideas on which to reflect. It does appear that there is now more common ground between all of those involved with direct investment, providing a firmer basis to develop mutual understanding and co-operation geared to improving the flow of direct investment to developing countries and its contribution to development.

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