Contemporary Issues on Foreign Direct Investment

Statistics and Promotion Policies: a Research Report

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The Minerva Program XI – April 2000
Acknowledgements

It always becomes a common place to say that many people and circumstances gave their contribution to this monograph. Nevertheless, I wouldn’t be fair if I didn’t mention some of those who gave me support for this work.

First of all, I must thank my sponsors, the Central Bank of Brazil and the Brazilian sponsors for the Minerva Program, for the financial support for the four-month stay in Washington, DC. The administrative support was very effective at the Training Division in the Central Bank, specially from Euro Gama Barbosa e Helena Taketsugu da Silva, and also at the Instituto Cultural Minerva, where Shirley Pinheiro helped a lot.

Certainly, Dr. Jose Luiz Conrado Vieira (then Consultant at the Department of Foreign Capital - FIRCE) and the heads of FIRCE, plus Dr. James Ferrer, head of the Institute of Brazilian Business and Public Management Issues, at the George Washington University, deserve my gratitude for having believed in my potential and interest to provide some present and future contribution to the debate about the changes in the Brazilian economy and welfare.

A good and supportive team is essential to provide the motivation and the information to guide a research work. I do thank Ronaldo Jose de Araujo, Sergio Tavares Pereira and Maria Fatima Freire Meira for providing me with the right direction and insight for this task, sending me relevant material and telling me who were the right contacts in Washington. Roselene Muniz Lopes Moreira and my friends at the FIRCE’s branch in Belo Horizonte also helped by handling the daily work for someone who would be absent for almost four months.

My advisor, Prof. William C. Handorf, from the Department of Finance, at GWU, was very kind, objective and supportive with all his patience to review this relatively lengthy paper.

I also got fundamental cooperation from Mr. Raymond Mataloni, from the International Investment Division at the Bureau of Economic Analysis, who gave me extensive printed material on foreign direct investment statistics and methodologies, and sent very specific information about operational details. German Rios, from the Brazil Unit at the World Bank, provided me with very hard-to-find literature produced within the several agencies of the World Bank Group.

I share the credits with all those cited above and assume responsibility for eventual mistakes, misunderstandings and misinterpretations in this monograph, which I intend to be the first step of a deeper research work.
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Abstract

The ideas developed in this monograph provide a framework for thinking about the importance of productive foreign direct investment (FDI) in an emerging country as Brazil. FDI relates in several forms to the process of macroeconomic development and governments must be aware of that, giving the right importance and providing the necessary resources to promote consistent data gathering and information availability on FDI to support the needs of the society and foreign investors in terms of better allocation of resources.

The basic relationships among FDI and the economy are commented, followed by some reflections about the most recent numbers on FDI, worldwide, in Latin America and in Brazil. The analysis proceeds with a discussion on the need for improved and standardized methodologies for FDI statistics, with comments on the procedures adopted in a developed country, the USA, and in an emerging country, Brazil. The study concludes with some recommendations in terms of successful FDI promotion policies and the need of a harmonic work between a national investment promotion agency and a national investment information agency.
### Glossary

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>BEA</td>
<td>Bureau of Economic Analysis</td>
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<tr>
<td>BIT</td>
<td>Bilateral investment treaty</td>
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<td>FDI</td>
<td>Foreign direct investment</td>
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<tr>
<td>FIRCE</td>
<td>Foreign Capital Department (Central Bank of Brazil)</td>
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<tr>
<td>IID</td>
<td>International Investment Division (a division of BEA)</td>
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<tr>
<td>IMF</td>
<td>International Monetary Fund (*)</td>
</tr>
<tr>
<td>IPANet</td>
<td>Investment Promotion Agencies Network (*)</td>
</tr>
<tr>
<td>LDC</td>
<td>Less-developed country</td>
</tr>
<tr>
<td>MERCOSUR</td>
<td>Southern Cone Common Market</td>
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<tr>
<td>M&amp;A</td>
<td>Mergers and acquisitions</td>
</tr>
<tr>
<td>OECD</td>
<td>Organization for Economic Cooperation and Development (*)</td>
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<tr>
<td>SCB</td>
<td>Survey of Current Business</td>
</tr>
<tr>
<td>SME</td>
<td>Small and medium-sized enterprises</td>
</tr>
<tr>
<td>TNC</td>
<td>Transnational corporation</td>
</tr>
<tr>
<td>UNCTAD</td>
<td>United Nations Conference on Trade and Development (*)</td>
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(*) Refer to “Appendix 1: List of organizations mentioned”, for more details
Preface

When making efforts for the implementation of a free market structure, it becomes very important for a country to have highly skilled and motivated personnel to perform strategic planning and leading practices in all fields related to the government responsibilities and attributions. There must be a continuous process of investing in the training of government officials, and resources should come either from the public budget or the private sector, conscious of its role in sponsoring effectiveness at all central administration levels.

It is in this context that the Minerva Program continues to be very welcome. It allows committed government officials to abstract from their daily duties and spend a precious time abroad assimilating and reviewing the basics of the theory and operation of a modern national economy. In this sense, the human resources policy at the Brazilian Central Bank has been very sensitive and supportive, and it has been stimulating its officials to live a few months in the United States, to get in touch with the new approaches of the market economies, and also understand the need for paradigm shifts that are very important to Brazil.

The country’s reality has changed a lot during the 1990s. The liberalization of the economy, in its several aspects, has meant significant changes in the financial mediation process, with deep impact over the structure of the national financial system and the way Brazilian firms finance their capital needs in order to face the increasing competitiveness in the world economy. As a result, numerous investment opportunities came up for both Brazilian and foreign savings, through very selective investors.

The sudden increase in the capital flows brought about the need for Brazilian authorities to improve and adapt their institutions to the new global scenario. The Central Bank of Brazil, through its Department of Foreign Capital (FIRCE), has been taking a consistent approach towards deregulation of capital flows, and this requires a market-driven orientation, with intensive use of information systems and the Internet. FIRCE clearly states, in its mission, its role and commitment as an information unit responsible for high-quality work in terms of monitoring capital flows inward and outward the country, and providing the society with reliable data on foreign direct investment (FDI) and foreign portfolio investment.

This monograph aims to be an initial effort to address the question of how FIRCE can make the next step ahead in terms of improving its statistical capabilities and methodologies on FDI data. Thus, several important issues are addressed here, from the basic theory of FDI to the state-of-the-art methodologies, from recent worldwide statistics to FDI promotion policies for sustainable macroeconomic development.

Consequently, due to the limitations of time and scope, I did not intend to be perfect or conclusive on all subjects investigated. This overview ends up suggesting some actions and research work that could be performed, but the main contribution may be in the questions it brings about. Of course, the analysis and opinions presented herein represent my personal views, but not necessarily those of FIRCE and those of the Institute of Brazilian Business and Public Management Issues (IBI), at the George Washington University, where the Minerva Program takes place. Any reader comments, contributions and suggestions are very welcome for the continuity and improvement of this research.

Washington, DC, April 2000
Introduction

The development priorities of developing countries include achieving sustained income growth for their economies by raising investment rates, strengthening technological capacities and skills, and improving the competitiveness of their exports in world markets; distributing the benefits of growth equitably by creating more and better employment opportunities; and protecting and conserving the physical environment for future generations. The new, more competitive, context in which economic activity takes place imposes considerable pressures on developing countries to upgrade their resources and capabilities if they are to achieve these objectives. Rapid advances in knowledge, shrinking economic space and rapid changes in competitive conditions, evolving attitudes and policies, and more vocal (and influential) stakeholders characterize this new global context.

International capital flows of capital perform a variety of functions in the world economy. For example, they permit levels of domestic investment in a country to exceed the country’s level of saving. This has been the case for the United States economy for the last 15 years and for most of the last 25 years, and for Brazil in the last five years. For rapid growing countries, inflows of foreign investment permit faster growth, and/or growth with less sacrifice of current consumption, than could otherwise take place. For countries generating large amounts of saving, international capital flows provide a means to invest where returns are higher than at home, as was the case for Great Britain in the 19th Century and Japan more recently (1980s).

Amidst all the upheaval in capital markets over the past decade, foreign direct investment (FDI) has come to play an unprecedented role as a source for management, technology, and external funding for the developing countries. Surrounded by instability in equity markets and in international lending, FDI is also the most stable source of outside capital. Embodied in plant, equipment, or workforce, it may expand or contract in response to underlying economic conditions, but not flee with the rapidity of stock market investors or commercial bank lenders.

A vital part of the new context is the need to improve competitiveness, defined as the ability to sustain income growth in an open setting. In a liberalizing and globalizing world, growth can be sustained only if countries can foster new, higher value-added activities, to produce goods and services that hold their own in open markets. FDI and international production by transnational corporations (TNCs) can play an important role in complementing the efforts of national firms in this respect. However, the objectives of TNCs differ from those of host governments: governments seek to spur national development, while TNCs seek to enhance their own competitiveness in an international context.

FDI is also viewed as a way of increasing the efficiency with which the world’s scarce resources are used. An example is the perceived role of FDI in efforts to stimulate economic growth in many of the world’s poorest countries. Partly this is because of the expected continued decline in the role of development assistance (on which these countries have traditionally relied heavily), and the resulting search for alternative sources of foreign capital. More importantly, FDI can be a source not just of badly needed capital, but also of new technology and intangibles such as organizational and managerial skills, and marketing networks. FDI can also provide a stimulus to competition, innovation, savings and capital formation, and through these effects, to job creation and economic growth.
It is important to recognize that not everyone is enthusiastic about these developments. Critics are concerned about the possible negative effects of FDI. In home countries, where the outflow of capital originates, there are claims that FDI exports jobs and puts downward pressure on wages. In host countries, which receive the FDI, there are worries about the medium-term impact on the balance of payments, about potential monopolization of the domestic market, and more generally about the impact of FDI on government’s ability to manage the economy. Critics are also worried about the implications of having a multilateral agreement that lays down common standards for national FDI rules and requires each signatory to bind its rules under the agreement. Having to bind on national FDI policies under a multilateral agreement would be viewed by critics as going even further in pre-empting a country’s right to manage inflows of FDI.

In spite of these worries, direct investment has accounted for about a quarter of total international capital outflows in the 1990s and appears to have grown, relative to other forms of international investment, since the 1970s. The United States was by far the major source of direct investment outflows in the early 1970s, but Europe caught up to the United States in the 1980s and Japan almost did, before fading in the 1990s. The United States shifted from being the largest net supplier of direct investment to absorbing much of the world's supply, especially in the late 1980s, and then reverted to its earlier net supplier role. Direct investment flows have been the least volatile source of international investment for most countries, the chief exception being the United States, which has flipped back and forth from dominant net supplier to dominant net recipient, and back to dominant net supplier.

FDI has been one of the defining features of the world economy over the past two decades. It has grown at an unprecedented pace for more than a decade, with only a slight interruption during the recession of the early 1990s. More firms in more industries from more countries are expanding abroad through direct investment than ever before, and virtually all economies now compete to attract transnational corporations (TNCs).

This trend has been driven by the complex interaction of technological change, evolving corporate strategies towards a more global focus and major policy reform in individual countries. The past decade has witnessed an unparalleled opening and modernization of economies in all regions, encompassing deregulation, demonopolization, privatization and private participation in the provision of infrastructure, and the reduction and simplification of tariffs. An integral part of this process has been the liberalization of foreign investment regimes. Indeed, the wish to attract FDI has been one of the driving forces behind the whole reform process. Although the pace and scale of reform has varied depending on the particular circumstances in each country, the direction of change has not.

Openness to foreign investment nevertheless remains partial in many countries. While there has been a growing acknowledgement of the role that direct investment can play in stimulating economic growth and development, there remains a tremendous diversity in approaches of countries in their policies towards FDI, as well as a lingering skepticism in certain spheres as to the inevitability or universality of the benefits from FDI. There is a strong feeling worldwide that more research and analysis is needed about the critical issues at stake in a multilateral framework on investment. Several issues are deeply related to the effects of economic policy liberalization on the quantity, quality and distribution of FDI, and its impact on development. As a result, many countries screen incoming investment and retain extensive controls on foreign participation in particular sectors. Performance requirements on investment are sometimes still considered necessary.
or desirable to ensure that the activities of foreign TNCs are consonant with host country development strategies.

Direct investment by TNCs has the potential rapidly to restructure industries at a regional or global level and to transform host economies into prodigious exporters of manufactured goods or services to the world market. In so doing, FDI can serve to integrate national markets into the world economy far more effectively than could have been achieved by traditional trade flows alone. As with private sector investment more generally, the benefits from FDI are enhanced in an environment characterized by an open trade and investment regime, an active competition policy, macroeconomic stability and privatization and deregulation. In this environment, FDI can play a key role in improving the capacity of the host country to respond to the opportunities offered by global economic integration, a goal increasingly recognized as one of the key aims of any development strategy.

Integration with the global economy does not just come through direct exports of foreign-owned firms. It also derives from the presence of foreign TNCs in sectors providing goods and services to exporters. One such area is in the provision of infrastructure. The infrastructure needs of many countries often go beyond the ability of host governments to finance. Foreign investors have participated actively in the privatization of utilities in South America and Asia, particularly through build-operate-transfer schemes in the case of the latter.

In other areas that impinge on the attractiveness of economies for investors, reforms have been slower in a number of countries and foreign investors have been much less actively courted. One such area is financial services. The weakness of the financial sector throughout emerging Asia has been highlighted by the recent turmoil. It remains to be seen whether this will lead to a greater openness towards foreign financial institutions, but a strong case can be made that foreign participation in the local financial sector can help to reduce the risks of future crises.

The Asian, the Russian and the Brazilian financial crisis have not altered these fundamental arguments for greater liberalization. Indeed, it has made the case for such openness even more compelling. Some of the structural weaknesses which have come to light over the past years can be related to policies which restricted FDI or private sector investment more generally, or which sought to channel such investment into particular sectors. Policies towards FDI have often been part of broader industrial strategies.

Beginning in the mid-1980s, more and more developing and transition countries changed their views about foreign investment, switching from a wary, regulatory stance to a welcoming, promoting stance. Technological changes have also made FDI easier and more profitable. The response has been phenomenal: Amounts of foreign direct investment have grown explosively, with flows to developing countries increasing even faster than those to the industrialized world. Averaging less than US$3 billion per year in the 1970s and less than US$10 billion in the 80s, inflows of FDI to developing and transition countries reached US$145 billion in 1997—more in one year (in real terms) than during the entire decade of the 80s, and 13 times their level ten years earlier in 1987. FDI was in third place among the capital flows to developing countries through the 1960s, 70s and early 80s—aid flows and commercial bank loans were larger. But aid hit a plateau, and commercial lending dried up after the 1982 debt-crisis, while FDI continued to increase. It has been the biggest source of capital for the developing world since 1993.

The structure of this monograph brings four chapters. In Chapter 1, there is a discussion on some contemporary issues related to FDI and its relation to the transnational
corporations’ strategies, the differences concerning portfolio investment, the impacts on technology and employment, the effects in terms of domestic competition. In what concerns governments, there are comments of the influence of FDI over the balance of payments, macroeconomic stability and international trade. Some thoughts are also shown in terms of the liberalization process, regional integration and multilateral agreements. Environmental issues come at the end.

Chapter 2 brings some updated FDI statistics at a global, Latin-America and Brazil level. It shows the importance of mergers and acquisitions in terms of investment flows and presents the recent history of FDI in Brazil, with emphasis on the privatization process.

It is very important and strategic for a country and also for foreign investors to have accurate information on FDI flows inward and outward of its borders. Chapter 3 goes into the statistical methodologies that are adopted worldwide and the need for standardization. The procedures adopted in the United States are viewed as a benchmark for Brazil, because of the large North-American experience in dealing with industry data and establishing consistent surveys on a timely basis. This knowledge has been very useful for Brazil since the first Census of Foreign Capital, which took place in 1996.

The information itself allows governments to pursue effective public policy. Chapter 4 introduces the quest for sound FDI promotion policies and the main problems and achievements related to the creation of national investment promotion agencies, bringing some comments on the recent Brazilian experience on FDI promotion.

Last, but not least, the Conclusion brings some topics for further action and research are presented.

The Bibliography section contains the literature effectively used for this work, and the Supplementary Bibliography refers to useful literature that was reviewed but was not mentioned due to space, time and objectivity reasons.

Appendix 1 describes some of the organizations, in Brazil or worldwide, that deal with FDI issues.

Appendix 2 summarizes the current reporting requirements for FDI in the United States.

Appendix 3 brings an extensive reference in terms of the literature presently available on FDI at the Library of the Congress, in Washington, D.C., which may come to be useful for further research on the subject.
1. FDI contemporary issues

1.1. FDI: definition

The definition of direct investment, and therefore its measurement, have changed considerably over time. Definitions and measurements even now differ among countries despite the efforts of international agencies to push for uniformity. The United States was a pioneer in surveying both outward and inward direct investment. The object of the surveys, as described in the 1937 inward investment survey, was to measure “...all foreign equity interests in those American corporations or enterprises which are controlled by a person or group of persons...domiciled in a foreign country”.

The current definition of direct investment, endorsed by the OECD and the International Monetary Fund, avoids the idea of control in favor of a much vaguer concept: “foreign direct investment reflects the objective of obtaining a lasting interest by a resident entity in one country (direct investor) in an entity resident in an economy other than that of the investor (direct investment enterprise). The lasting interest implies the existence of a long-term relationship between the direct investor and the enterprise and a significant degree of influence on the management of the enterprise”.

OECD recommends that a direct investment enterprise be defined as an incorporated or unincorporated enterprise in which a foreign investor owns 10 per cent or more of the ordinary shares or voting power of an incorporated enterprise or the equivalent of an unincorporated enterprise. An effective voice in the management, as evidenced by an ownership of at least 10 per cent, implies that the direct investor is able to influence, or participate in the management of an enterprise; it does not require absolute control by the foreign investor.

The idea of control, which is behind much of the literature on multinationals, has been specifically abandoned. The Fifth edition of the IMF Balance of Payments Manual points out that the concept of direct investment now used “...is broader than the concept of foreign-controlled, as distinguished from domestically controlled resident enterprises”. A single “direct investment enterprise” could be part of several different multinational firms, possibly from several countries. Duplication is avoided in investment flow and data, the main areas of concern to the OECD and the IMF, by allocating the financial aggregates to the various owners according to the extent of their ownership. However, data on the activities of multinationals, particularly those collected by home countries on, for example, the sales, employment, or output of their multinational firms or their overseas operations, could easily contain duplication if the 10 per cent criterion is used.

Thus, FDI occurs when an investor based in one country (the home country) acquires an asset in another country (the host country) with the intent to manage that asset. The management dimension is what distinguishes FDI from portfolio investment in foreign stocks, bonds and other financial instruments. In most instances, both the investor and the asset it manages abroad are business firms. In such cases, the investor is typically referred to as the “parent firm” and the asset as the “affiliate” or “subsidiary”.

There are three categories of FDI, used in balance-of-payments statistics, according to the recommendations of the International Monetary Fund:

- **Equity capital** is the value of the TNC’s investment in shares in a foreign country. An equity capital stake of 10 per cent or more of the ordinary shares or voting power in an incorporated enterprise, or its equivalent in an unincorporated
enterprise, is normally considered a threshold for the control of assets. This category includes both mergers and acquisitions (M&A) and “greenfield” investments (the creation of new facilities). M&A are an important source of FDI for developed countries, although the relative importance varies considerably.

- Reinvested earnings are the TNC’s share of affiliate earnings not distributed as dividends or remitted to the TNC. Such retained profits by affiliates are assumed to be reinvested in the affiliate. This can represent up to 60 per cent of outward FDI in countries such as the United States and the United Kingdom.

- Other capital refers to short or long-term borrowing and lending of funds between the TNC and the affiliate.

1.2. FDI and TNCs’ strategy

A global strategy does not necessarily imply a worldwide strategy. The choice of locating a direct investment within the framework of a global strategy is very selective. This is the main reason why the trade-off assumption has to be reformulated. The trade-off game is limited to a few countries, and they are precisely those that have to compete among themselves to attract FDI. Thus, TNCs follow a global strategy in which they do not consider all countries as places to invest, developing countries in particular. On the contrary, they are very selective in their decision-making regarding the locations most conducive to FDI.

According to Michalet, it is possible to derive two kinds of trade specialization, based on the ideas of Paul Krugman and J.R. Markusen. These two kinds have direct effects in terms of FDI flows:

- North-south trade, also called “vertical” or “Ricardian”. This refers to inter-industry trade, and specialization is a result of different national factor endowments.

- North-north trade, also referred as “horizontal” or “Krugmanian”. This is intra-industry trade, and specialization is a result of economies of scale and product differentiation in monopolistic markets.

Consequently, the author proposes two distinct types of TNCs’ strategy:

- a North-South or “vertical” or “outsourcing” strategy: by investing abroad, TNCs are trying to minimize their costs. They are producing abroad in countries with lower labor costs, lower commodity prices, lower energy costs and lower real estate prices. Two crucial assumptions have to be made for this strategy to work: transportation costs and tariff barriers must be low.

- a North-North, “horizontal”, “market seeking” or “multi-domestic” strategy. The main motivation for TNCs is to have access to big consumer markets. The principal assumptions for this strategy are that transportation costs and tariff barriers are high.

The results of Michalet’s survey show that in the future, most TNCs would like to combine both strategies (i.e., market seeking and outsourcing) at one location. This could be called a global strategy. Its aim is to shift FDI, guided by market-seeking and outsourcing motivations, on a regional basis. As a result of the availability of low cost natural and human resources (the so-called Ricardian argument), and of economies of scale and product differentiation (the so-called Krugmanian argument), worldwide firms’ competitiveness will increase tremendously. The successful implementation of a global
strategy implies a set of preconditions: first, FDI localization characteristics, and second, a selective approach of potential host countries.

1.3. FDI and portfolio investment

Global flows of FDI have reached record levels in recent years, growing faster than merchandise trade and representing the most important form of foreign capital inflows for many developing countries. These capital flows, which typically fall into three major categories – portfolio flows, loans and FDI – perform a variety of functions in the world economy. Their common traditional role lies in the blending of foreign savings with domestic savings to finance domestic investment. FDI, distinct from all other types of capital flows, performs an important additional function. FDI is not only an exchange of the ownership of domestic investment sites from domestic residents to foreign residents, but also a corporate governance mechanism in which the foreign investor exercises management and control over the host country firm. In so doing, the foreign direct investors gain inside information about the productivity of the firm under their control – an obvious advantage over the uninformed domestic savers. Taking advantage of their superior information, the foreign direct investors will tend to retain the high productivity firms under their ownership and control and sell the low productivity firms to these uninformed savers. This adverse selection problem, which plagues the domestic stock market, leads to over-investment by the foreign direct investors even up to a point that, although first best capital inflows through FDI are not warranted, they nevertheless take place.

FDI can be understood as capital invested for the purpose of acquiring a lasting interest in an enterprise and of exerting a degree of influence on that enterprise’s operations. Direct investment differs from portfolio investment in that it involves active control of part or the whole of the asset in question, while portfolio investors are passive investors, motivated only by the rate of return on the asset.

FDI is different from foreign portfolio investment, concerning relevant information about domestic firms. Through the stationing of managers from the headquarters of multinational firms in the foreign direct establishments in the destination countries under their control, Foreign direct investors can monitor closely the operation of such establishments, thus circumventing these informational problems. Furthermore, foreign direct investors not only have an informational advantage over foreign portfolio investors, but they are also more informed than domestic savers. Because FDI entails direct control on the acquired domestic firm, which the typical domestic savers with ownership position in the firm do not have. Being “insiders” the foreign direct investors can “overcharge” the uninformed domestic savers, the “outsiders”, when multinational subsidiaries shares are traded in the domestic stock market. Anticipating future domestic stock market trade opportunities, in advance, foreign investment becomes excessive. However, unlike the home-bias informational problem, which leads to inadequate foreign portfolio capital inflows, excessive FDI flows under the insider-outside informational problem call for a non-tax corrective policy. First, because they are governed by unobservable variables (such as the productivity level which triggers default, according to the firm contract with its lender). Second, because there are self-fulfilling expectations equilibria which cannot be efficiently corrected by taxation. The corrective policy tool that is left available is then simply quantity restrictions on FDI.
Another important aspect of FDI is that it has proven to be resilient during financial crises. In situations of international illiquidity, when the country’s consolidated financial system has short term obligations in foreign currency in excess of foreign currency that the country has access on short notice, FDI flows provide the only direct link between the domestic capital market in the host country and the world capital market at large. For instance, FDI flows to East Asian countries were remarkably stable during the global financial crises of 1997-98. In sharp contrast, portfolio equity and debt flows, as well as bank loans, dried up almost completely during the same period. The resilience of FDI to financial crises was also evident in the Mexican crisis of 1994 and the Latin America debt crisis of the early 1980s. This may reflect a unique characteristic of FDI, which is determined by considerations of ownership and control by multinationals of domestic activities, which are more long-term in nature, rather than by short-term fluctuations in the value of domestic currency and the availability of credit and liquidity.

1.4. FDI and technology

FDI by TNCs is considered to be a major channel for the access to advanced technologies by developing countries. TNCs are among the most technologically advanced firms, accounting for a substantial part of the world’s research and development (R&D). In the last decade, some work on economic growth has highlighted the role of FDI in the technological process of developing countries. FDI may increase the rate of technical progress in the host country through a “contagion” effect from the more advanced technology and management practices used by the foreign firms.

There are good reasons to think that TNCs are important vehicles for the direct and indirect transfer of technology between countries. Superior technology or capacity to innovate figure prominently among the attributes a firm engaging in FDI relies on to compensate for the cost disadvantage, relative to local firms, associated with foreign operations. This technological superiority on many TNCs has led researchers worldwide to emphasize the efficiency-enhancing characteristics of their foreign investment. Apart from the diffusion of TNC technology through spillovers, FDI may also produce other unintended efficiency-enhancing effects, as when local rivals are forced to upgrade their own technological capabilities as a consequence of competitive pressure from the local affiliate of a TNC.

In order to examine empirically the role of FDI in the process of technology diffusion and economic growth in developing countries, a research was made in order to test the effect of FDI on economic growth in a cross-country regression framework, utilizing data on FDI flows from industrial countries to 69 developing countries over the last two decades. The results suggested that FDI is an important vehicle for the transfer of technology, contributing relatively more to growth than domestic investment. However, the higher productivity of FDI holds only when the host country has a minimum threshold stock of human capital. In addition, FDI has the effect of increasing total investment in the economy more than one for one, which suggests the predominance of complementarity effects with domestic firms. The most robust finding of the research was that the effect of FDI on economic growth depends on the level of human capital available in the host economy. The main contribution perceived of FDI to economic growth comprised two effects. First, FDI increases the overall level of investment, attracting higher levels of domestic investment. This effect is not enhanced by the interaction with human capital.
And second, FDI is more productive than domestic investment, a result that does depend on the interaction with human capital. This is a statement that has to be object of research in Brazil, to be proven or not.

Nevertheless, different types of distortions may jeopardize the above role of FDI as a means of advanced technology transfer. For example, because of protectionist trade policies, FDI may be the only way to access domestic markets by firms that would otherwise export the products to the host country. Similarly, governments may offer a set of incentives to foreign investors to stimulate the inflow of FDI, with the objective of increasing foreign exchange reserves or of developing certain sectors considered strategic from an industrial policy viewpoint. The effect of these policies may be a flow of FDI that does not correspond to higher efficiency but only to profit opportunities created by distorted markets. These considerations make the empirical evaluation of the performance of FDI an appealing question, a task that could be performed by the Brazilian Central Bank and/or the Brazilian investment promotion agency.

1.5. FDI and employment

The relationship between employment and income distribution (or relative wages of different types of labor) and globalization is one area where trade and investment issues are most closely related. For instance, outsourcing by local firms from their affiliates abroad (hence through FDI) plays an important role in this process. When a firm shifts production abroad, it is presumed to have a direct effect on domestic employment in that sector and an indirect effect on relative wages in the home country through the increased imports which flow from affiliates in lower wage locations.

One must say, however, that there is considerable divergence in views among economists about the employment effects of foreign direct investment. One key issue is the extent to which direct investment abroad substitutes for investment at home. Another is the extent to which FDI stimulates increases of exports of intermediate goods as well as capital goods. Still another concerns the matter of whether the direct investment involves the construction of new plants or simply the acquisition of existing facilities.

Empirical research on home country employment effects has taken an indirect approach, focusing on linkages between FDI and trade, on the assumption that a net expansion in exports will translate into a net increase in employment, and vice versa for a net increase in imports. The basic presumption is that exports create employment, while imports destroy employment, and that production in foreign affiliates replaces home country production for export and domestic consumption. The empirical evidence largely contradicts the latter assumption. With regard to the former, it should be emphasized that the meaning of job creation and destruction is not so simple. The relevant question is not whether a particular FDI project creates or destroys employment, but whether FDI in the aggregate increases or decreases domestic employment.

Historically, perceptions regarding the potential employment effects of FDI flows to host developing countries have ranged from very negative to very positive. On the negative side, it has been argued that the management, entrepreneurial skills, technology, and overseas contracts provided by TNCs may have little impact on developing local sources of these scarce skills and resources and may in fact inhibit their development, as a result of the TNCs dominance of local markets. The empirical evidence, however, overwhelmingly rejects this view. An alternative view is that TNCs can fill critical management gaps,
facilitating employment of local labor and transferring skills to local managers and entrepreneurs. Clearly, effects in individual cases will depend on the practices of the TNCs themselves, on the regulatory environment in which they operate, and on the initial skill level of local employees. This calls attention to the fact that many labor market effects of FDI are closely related to the technology transfer aspects of FDI, particularly as regards the upgrading of skills. Inflows of FDI also increase the amount of capital in the host country. Even with skill levels and technology constant, this will either raise labor productivity and wages, allow more people to be employed at the same level of wages, or result in some combination of the two (of course, if the inflows are negligible relative to the size of the labor force, the productivity and wage effects for the average worker will also be negligible).

Recent studies have been made on the impact of current trends in trade and direct investment on employment and wages in several countries. Most of the conclusions are that such factors as changes in labor supplies, technology and demand are more important than changes in trading patterns in accounting for changes in employment and shifts in relative wages. However, further studies are needed to understand better the employment and wage impact of FDI. More research becomes necessary, in terms of business cases about the actual investment experiences of various firms and industries in different countries before reaching reliable conclusions. Surely, there is a great need of such studies in the Brazilian economy.

1.6. FDI and domestic competition

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

There may be, however, situations where foreign investments reduce competition in the domestic market. In particular, if the investment is through the acquisition of a domestic producer by a foreign firm already exporting into that market, competition may be reduced through increased concentration. The presence of foreign firms in a domestic market may also complicate the task of the national competition authority, particularly if cartel activity is suspected, as information necessary to the investigation of a cartel is spread across the jurisdictions of several countries.

1.7. FDI and the balance of payments

FDI may appear as just another form of private capital flow in the balance of payments, but it differs in important ways from other forms of investment, and this has implications for the issues mentioned above. Evidence from the daily work at the Central
Bank of Brazil suggests that FDI is less likely to raise such problems than other types of capital inflows. Direct investment involves much more stable and generally smaller amounts of capital than portfolio investment and credits. Besides that, they represent long-term, carefully selected investment projects that cannot be liquidated at short notice. Transaction costs involved are usually higher when an investor establishes an enterprise compared to the purchase of short-term bonds or options.

Furthermore, direct investment most often takes the form of equity capital, which, as opposed to debt creating instruments, imposes no obligations on the debtor to make fixed interest payments and to reimburse the principal at a determined date. A foreign investor may be unable or unwilling to liquidate his shares unless he can find a counterpart willing to buy them at the desired price. Finally and perhaps even more importantly, in the absence of perfectly fluid markets and substitutable financing instruments, direct investment can be expected to contribute to the financing of productive investment in a higher proportion than portfolio investment and credits, thereby enhancing the host country’s capacity to assure the service of its debt through increased exports at a later stage.

Concerns have been expressed that foreign investment liberalization may adversely affect the balance of payments. The net contribution of foreign investment to the host country’s balance of payments could become negative over time if profits are systematically repatriated abroad rather than reinvested locally or if foreign-controlled enterprises display a greater propensity to source abroad than domestic firms. For any given investment project, repatriated profits once the affiliate is profitable may exceed initial inflows of equity capital in the long run. The retained earnings of the affiliate will usually sustain the investment. Based on this notion of the investment cycle of a foreign investment project, it has been argued that FDI may lead to a deterioration in the balance of payments position of the host country over time. Such reasoning is flawed for several reasons.

First, FDI also affects the balance of payments through the trade account, with net exports from the affiliate potentially offsetting net capital outflows. In the short term and depending on the sector, an investment is likely to be accompanied by an increase in imports of capital goods from the home country as the investor establishes a production facility. In the longer term, however, the investor is likely to begin to export from the host country, provided host country policies are such that the affiliate is able to compete with producers elsewhere. The net effect on the balance of payments from these offsetting current and capital accounting flows is difficult to determine a priori. There might be future problems, however, when the foreign direct investor buys firms in the non-tradable sectors.

Second, the experience of an individual investment project is not the full story. FDI is a continuous process: as some older investors begin to repatriate profits, new arrivals inject additional equity capital into the host economy and existing investors expand their presence through retained earnings. Both forms of investment are recorded as capital inflows in the balance of payments.

Third, more important than the actual direct effect of inward investment on the balance of payments is the long-term indirect benefit derived from transfer of technology and know-how to domestic producers. These transfers improve the overall ability of the host country to export and hence allow the economy to sustain greater inflows of foreign capital over time. To focus only on the direct impact on the balance of payments of individual investments misses these important indirect gains to be derived from inward investment.
1.8. FDI and macroeconomic stability

Another source of concern is related to the effects of FDI on macroeconomic stability. It has been noted that, if the inflow of capital becomes very large, it may complicate the conduct of monetary and exchange rate policies and, in particular, the implementation of macroeconomic stabilization programs: large capital inflows may put upward pressure on the real exchange rate.

Depending on the monetary policy setting, this would be the result of either nominal exchange rate appreciation or higher inflation. In both cases, the current amount deficit is likely to deteriorate – sometimes leading to deficits that are larger than desirable. Lastly, it has been pointed out that excessive reliance on external financing may make the economy, its banking sector in particular, vulnerable to sudden reversals in financial market conditions abroad and in foreign investors’ sentiment, as evidenced most recently by the crisis in Asia (1997), Russia (1998) and Brazil (1999).

The concerns with respect to private capital flows into developing countries have been receiving much attention since the turmoil in Southeast Asian financial markets. Before discussing the role that FDI might play in macroeconomic stability, there are some general points that need to be made.

First, greater international capital mobility improves global resource allocation by directing world savings to its most productive uses, allows recipient countries to maintain stable levels of investment and consumption in spite of fluctuations in their income, and sends important signals to host countries concerning the sustainability of their policies. With appropriate economic policies that do not distort the flow of capital into particular areas, these inflows allow the host economy to sustain higher growth rates than would otherwise have been possible. Second, domestic investors may contribute more to capital flight than foreign ones when economic conditions deteriorate. Third, capital controls impose a cost on the domestic economy through the inefficiencies, which they engender.

1.9. FDI and international trade

For the most part, empirical work on the linkages between FDI and trade has not tried to establish causation – that is, to determine, for example, whether inflows of FDI cause exports to be greater than they would otherwise be or if, instead, expanding exports attract increased FDI. The focus, rather, has been on the more modest goal of seeking to determine whether an increase in one is systematically associated with an increase or decrease in the other. In other words, whether they are correlated. This is commonly referred to as testing whether trade and FDI are substitutes (negatively correlated) or complements (positively correlated).

When the focus is on the interlinkages, the question of whether FDI and trade are substitutes or complements is of secondary importance. A substitute relationship can create as just as strong an interlinkage as a complementary one. And if they are interlinked, it means that trade policy affects FDI flows, and FDI policies affect trade flows, and therefore that both sets of policies would benefit from being treated in an integrated manner.

Most of the actual discussion worldwide has been so far concerned with the complexities of the relationship between FDI and home country trade, but it should be clear that it is not easy to determine a priori the relationship between FDI and host country trade. Again, the question of the relationship between FDI and trade can only be settled by
looking at the empirical evidence. This is particularly true because the wider and largely
dynamic effects of FDI in the host country – such as the stimulus to competition,
innovation, productivity, savings and capital formation – can be important. Since these and
other FDI-related dynamic effects are likely to affect the level and product composition of
the country’s imports and exports – including its trade with the home country – it is evident
that the relationship between trade and FDI is considerably more complex than is often
suggested.

Concerning the empirical evidence, four points should be emphasized:
- the theory has only provided limited guidance to the empirical work. This in turn
  makes it very risky to draw policy conclusions from individual studies.
- because data problems are particularly acute with regard to service industries,
  most research on FDI focuses on goods. This lack of empirical research on FDI in
  the services sector is increasingly troublesome, considering the growing
  importance of services in production, trade and investment.
- the theoretical literature is largely focused on analyzing the impact of an
  individual (marginal) investment. At the margin, incremental investment may
  have a very different set of implications from those related to the entire trade and
  FDI regime.
- as a result, empirical research on TNCs is largely limited to firms from just a few
countries, notably the United States, Sweden and Japan.

1.10. FDI and liberalization

It is very important to understand in which way FDI contributes to a local economy,
or in other words, what are its spillover effects or backward linkages. FDI has the potential
of bringing in new production, employment, human capital and technology. Liberalization
of FDI itself is not necessarily sufficient to realize the potential benefits of foreign
investment. Policies need to be developed to ensure transparency in law enforcement, good
corporate governance, proper accounting standards and disclosure rules, to promote
institution building and the formation of human capital. The promotion of partnerships
between foreign and local small and medium enterprises also deserves attention.

The period since the early 1980s has witnessed a widespread tendency towards
liberalization of national laws and regulations relating to foreign investment, especially in
developing and transition countries. In many cases, this liberalization of foreign investment
policies and regulations has been part of broader, market-oriented reforms of economic
policy and has proceeded in parallel with trade liberalization, deregulation and
privatization.

The recent trend to more open investment policies has been particularly evident in
the removal or relaxation of regulatory barriers to the entry of FDI. Screening procedures
involving prior authorization have been eliminated or reduced in scope. Closely related is
the liberalization of sectoral restrictions on the entry of foreign investment and of
limitations regarding foreign shareholding in local companies. There has also been a shift
away from the imposition of performance requirements and a liberalization of regulations
concerning the transfer of funds. In addition, there has been increasing acceptance of
standards of non-discriminatory treatment of foreign investors and of international
standards on matters such as compensation in case of expropriation. Finally, international
arbitration mechanisms for the settlement of disputes between foreign investors and host states have gained widespread acceptance.

At the same time, there are several qualifications to this liberalization trend. First, the trend has not been homogeneous and significant differences between foreign investment regimes persist. Second, virtually all countries maintain some restrictions, often of a sectoral nature, on the entry of foreign investment. In this connection, an issue that has attracted attention is the existence of reciprocity requirements with regard to the entry and treatment of foreign investment.

The liberalization of national laws and regulations has been accompanied by a rapid proliferation of intergovernmental arrangements dealing with foreign investment issues at the bilateral, regional and multilateral levels. Unilateral liberalization of national legal frameworks has not been found sufficient, and states around the world have increasingly recognized the crucial importance of international commitments to securing a stable and predictable legal environment for FDI.

1.11. FDI and multilateral agreements

Because postwar attempts to establish a binding multilateral agreement containing comprehensive rules on foreign investment have not been successful (more on this below), bilateral treaties for the promotion and protection of foreign investment have emerged as the predominant source of rules for the treatment of foreign investment. Bilateral Investment Treaties (BITs) typically contain a broad, flexible concept of "investment". It is viewed as a form of property and is usually defined through an open-ended (illustrative) list of assets, including movable and immovable property, ownership rights in companies, claims to money and intellectual property rights. The scope of the investments covered by the BIT in some cases has been expressly limited to investments made in accordance with the domestic law of the Host State or to investments approved or duly registered by the Host State. Another important aspect concerns the definition of the persons and companies that will be treated as investors of one of the parties. In this respect, BIT practice is marked by relatively important discrepancies, especially in regard to the definition of corporate nationality.

There are two main approaches to the admission of foreign investment. Most BITs require that, subject to their domestic laws, parties shall encourage and admit in their territories investments by nationals and companies of the other party. The reference to domestic laws means that the commitment to encourage foreign investment is subject to any existing or future restrictions on the entry of foreign investment contained in domestic legislation. The priority accorded in these BITs to domestic laws reflects the fact that historically these treaties have been designed primarily to regulate the treatment of foreign investment after admission. At the regional and multilateral level, a distinction can be made between, on the one hand, arrangements that cover only foreign investment and, on the other, arrangements that integrate rules on foreign investment into a broader framework of rules aimed at economic cooperation and integration.

In May 1995, following several years of preparatory work, OECD members launched negotiations with the aim of concluding a Multilateral Agreement on Investment (MAI). The main features of the proposed agreement are as follows: the centerpiece is a "top down" approach to liberalization of investment regimes through the application of national treatment and standards to both the establishment and the subsequent treatment of
investment; a broad, asset-based definition of investment; provisions on country specific reservations; standstill and roll-back obligations; provisions on transparency of domestic laws, regulations and policies; a limited set of general exceptions; standards for the protection of investments (general treatment standards and specific standards on expropriation and compensation, transfer of funds, protection from civil strife, and so forth); and dispute settlement procedures through state-state arbitration and investor-state arbitration. In addition, consideration is being given to the possible inclusion of disciplines on investment incentives, performance requirements, movement and employment of key personnel, corporate practices, privatization and monopolies and state enterprises. It has to be decided whether the MAI should provide for substantial liberalization commitments immediately upon entry into force, or should be more in the nature of a standstill agreement, coupled with a mechanism for progressive liberalization over time.

There has not been enough agreement about the need for an MAI, even though the pendulum is swinging more towards the “multilateralists”. While the need for FDI is generally recognized, even among the skeptics, the push for an international agreement has been rather lukewarm in some countries. This lack of enthusiasm or sometimes even an outright hostility could be a serious problem for the international trading system and for capital markets. First, the question of MAI divides the WTO member countries into those who support the idea of an agreement and those who are against it. In other words, this is a divisive issue that could also hamper progress in other areas of WTO jurisdiction. Second, the division has gone along the lines of important country groupings – developed versus some less developed countries (LDCs). This, too, is a serious business because of the interest of the developed countries in having LDCs integrated into the multilateral trading system. Third, FDI has been growing dramatically over the last decade or so, resulting in a rapid pace of globalization, and a significant contribution of foreign capital to investment in many countries of the world. Unfortunately, the growth of FDI has been uneven, with some LDCs benefiting more than others, leading many people in academia and policy to fear that the latter countries, or at least some of them, will be “marginalized”. Fourth, there does not seem to be an agreement on the need for an MAI among international public institutions that give advice on trade and investment policies to countries.

The arguments in favor of a MAI ultimately rest on the benefits the countries can reap from such an agreement. The list of major benefits to the international community at large is impressive:

- growing importance of FDI
- transparency, predictability and legal security
- national legislation is no alternative to a consistent MAI
- policy coherence
- marginalization of non-signatories
- competition for FDI among all countries

The most common arguments against a MAI are:

- security considerations
- political objectives of governments
- corporate “malpractices”
- status quo (UNCTAD support for current agreements, stating that they are already good enough)
- negotiation strategy (many countries are not ready yet to conduct negotiations)
- inefficient mechanism of global negotiations
Nevertheless, the host countries should also consider other benefits that are particularly important for developing countries. For example, MAI would reduce transaction costs to TNCs resulting in greater supply of “investible funds” or lower costs of FDI or both. The agreement would also reduce uncertainty that is typically a major component of investors risks’. Since the agreement would also most likely include elements that can be seen as ‘prudential regulations’ it would certainly reduce the volatility of capital flows. Moreover, MAI would be an important instrument towards avoiding unilateral restrictions against each country’s exports. Last but not least, since MAI would also include a dispute settlement mechanism, it would give weaker and smaller countries a better chance to protect their rights.

1.12. FDI and regional integration

Market size is an important consideration for a TNC contemplating a particular FDI. By removing internal barriers to trade, a free trade area or customs union gives firms the opportunity to serve an integrated market from one or a few production sites, and thereby to reap the benefits of scale economies. This can have a pronounced impact on investment flows, at least while firms are restructuring their production activities. The single market program of the European Union stimulated substantial investment activity, both within the Union and into the Union from third countries, and similar effects on FDI flows have been observed for other regional trade agreements, as such as the MERCOSUR.

International direct investment is increasingly recognized as an engine of economic growth and a powerful force for global and regional integration. In order to evaluate the impacts of such a force, some research has been undertaken concerning the investment effects of regional integration agreements, as such as NAFTA and MERCOSUR and the discussion is mostly about how these arrangements may affect inward and outward foreign direct investment flows in the integrating region. Recent years have witnessed a deepening and widening of European integration and a proliferation of new regional integration agreements throughout the world. Although some integration agreements have been motivated by political considerations, it is clear that economics is generally the driving force: countries enter into such agreements because integration promises various economic benefits. In the short run, integration is expected to stimulate intra-regional trade and investment and, in the long run, it is hoped that the combination of larger markets, tougher competition, more efficient resource allocation, and various positive externalities will raise the growth rates of the participating economies.

The perhaps most serious challenge facing the studies of the relation between regional integration and foreign direct investment is the multi-dimensional character of the issue. There is reason to believe that the effects will vary between different integration agreements, and between countries and industries participating in any specific agreement. For instance, the degree of integration at the outset, and the significance and nature of the changes brought about by the regional integration agreement, will matter for the outcome. The patterns of trade and investment at the outset will determine how much adjustment is necessary after the agreement.

Countries where outward FDI flows are initially very large are not likely to be affected the same way as countries where inflows of FDI are dominant. Integration between developed countries may differ from integration between countries at different levels of development, depending on how competitive and complementary the economies are. In
many instances, FDI may actually be an essential catalyst for dynamic benefits. Some of the improvements in economic efficiency associated with increased specialization, exploitation of scale economics, and greater geographical concentration of individual economic activities are likely to be driven by inter and intra-regional FDI. Increased FDI flows are also important forces behind the heavier competitive pressure that is expected to encourage local producers to adopt efficiency-enhancing strategies, such as rationalizing plant capacity or reducing slack in the production process. In addition, it is likely that FDI will stimulate technology transfer and diffusion, both directly and through spillovers to local firms.

Regional integration in the Southern Cone of the Western Hemisphere dates back to 1986, with a bilateral agreement between Argentina and Brazil, which stimulated the elimination of all trade barriers over a ten-year period, what has not been accomplished yet as to date. Five years later, in 1991, this agreement was extended under the Treaty of Asuncion, with the purpose of creating a Common Market in the region. The resulting agreement is the MERCOSUR, which also includes Paraguay and Uruguay as members.

In the 1990s, foreign investment in Brazil has fluctuated considerably and the FDI flows have fallen short of those to Argentina, although the Brazilian market is about three times larger. One reason is that market-oriented reforms were introduced later and macroeconomic liberalization has been coming to Brazil at a slower pace than other countries in the region. Consequently, an unpredictable macroeconomic environment tempered the positive prospects connected with regional integration. However, the recent years have witnessed successful reforms and stabilization in Brazil, as well as the FDI flows have increased markedly. Brazil has replaced Argentina as the favored MERCOSUR location for FDI, especially since its currency devaluation on January 1999. The strong locational advantages of Brazil – in terms of market and supply of labor and natural resources – suggest that substantial flows of FDI may be expected in the medium run, assuming that the country’s macroeconomic environment remains stable.

1.13. FDI and the environment

This is a very polemic object and must be the object of a lot of research and discussion in Brazil. The rapid increase in FDI flows has generated considerable debate about its environmental implications, in particular the impacts on environmental quality in the investment host country. A broader issue is the role of FDI in promoting sustainable development. To date, much of the debate has been polemical in nature.

According to a study released by OECD, four key aspects of the FDI-environment relationship have dominated much of the research effort to date:

- **Environmental effects of private international finance.** FDI may generate both risks and opportunities for the environment, depending on the circumstances. On the one hand, FDI can generate new growth and new structural efficiencies, making larger investments in environmental protection possible. But it may also lead to increased production and consumption of polluting goods, or to expanded industrial activity (and thus, to increased emissions).

- **Environmental effects of FDI-based technology development and diffusion.** Foreign investors may bring modern technologies that represent environmental improvements over what is currently available in the country in which they are
investing. Thus, FDI-based economic expansion may offer the prospect of significant technology-based environmental improvements.

- **Impact of environmental standards on investment decisions by the firm.** A key question is whether or not higher environmental standards lead firms located in "high-standard" countries to move to jurisdictions with "lower" environmental standards (i.e. to "pollution havens"). Plant relocations may be the result of the higher costs associated with more stringent environmental standards, or they may simply be the result of other cost/quality advantages offered by the host location.

- **Environmental effects of international competition for FDI.** A related fear is that some jurisdictions will use lower environmental standards as a way of attracting new FDI. Countries could either lower their standards intentionally, or they could resist increasing their standards, in order to gain a competitive advantage.

In broad terms, the literature reviewed for this paper suggests that the technology effects of FDI are likely to be positive for the environment, and that TNCs will have an important role to play in making sure that this positive effect actually materializes. Structural shifts in FDI flows may also result in a lessening of environmental pressures, to the extent that the service sector is less environmentally intensive than manufacturing activities.

A significant gap in existing research relates to the scale effects of FDI on the environment, especially with regard to the potential influence of higher (FDI-induced) income levels on the demand for environmental quality. However, most empirical research suggests that firms will not generally move their operations to take advantage of lower environmental standards existing in the new location, and that efforts by national governments to compete for FDI by relying on lower environmental standards are unlikely to be very successful in the long-term.

The main environmental opportunities associated with FDI arise from the fact that FDI promotes higher incomes, which could lead to higher levels of investment in pollution prevention and control facilities. There is also the possibility of tapping into the better technologies, information, management systems, and training programs that foreign investors often have at their disposal. Finally, FDI offers the potential to link the economic fates of the developing and developed countries on those environmental issues likely to affect both groups.

The main environmental risks associated with FDI arise from two areas. **First,** higher incomes associated with FDI-induced growth may not "pull" environmental quality along with it fast enough, implying reduced environmental quality in certain countries, for certain pollutants, over potentially long time periods. Even where the link between higher incomes and improved environmental quality is a positive one, this link may not turn out to be strong enough to prevent absolute degradations in environmental quality from occurring.

**Second,** there is the possibility that competitive pressures may tempt some companies or countries to engage in a "race to the bottom" in environmental standards. There will certainly be individual companies and sectors that will be "losers" in the economic restructuring likely to accompany expanded FDI flows. Firms whose economic position seems to have worsened may well blame FDI for this, and seek political intervention to protect the status quo. They may also cite lower environmental standards in host countries as one reason that their enterprises have become non-competitive.

Nevertheless the fears of the "race to the bottom" in environmental standards, based on the idea of "pollution havens", may be generally unfounded. On the other hand, this
conclusion may not hold in specific cases, especially where the firms involved produce undifferentiated products (and where small cost differences make a significant difference to their profitability), or where the countries involved are under-capitalized and fast-growing.

There has been vigorous debate about the “race to the bottom” in environmental standards resulting from competition between countries, and also among regions within a country, to attract FDI. The so-called pollution haven hypothesis implies that competitive forces would push FDI away from countries with high environmental standards, or pull it towards those with low standards. Conversely, the notion of pollution halos suggests that FDI might promote the establishment of higher environmental standards through technology transfer effects or via existing management practices within multinational or other firms. Overall, there does not appear to be evidence corroborating the pollution haven hypothesis. On the other hand, there are some studies that are consistent with the pollution haven hypothesis.

A broader perspective is needed beyond just focusing on the issue of pollution havens and halos. More detailed studies are needed to examine the environmental impacts of FDI in different sectors and countries. For example, the environmental impacts of FDI will probably differ depending on whether that FDI is headed toward manufacturing industries, service industries or resource-using industries. These impacts and the significance of the costs of addressing them will also vary according to whether the FDI involves large multinationals, or smaller (and perhaps, domestic only) firms. There is also the problem of “cascading” pollution havens (i.e. where firms contract out their “dirty” production processes to other companies in order to appear “green” themselves.

Thus, for all of the above reasons, the fear of a general "race to the bottom" in environmental standards, based on competitiveness concerns, may be somewhat exaggerated. There are some sectors of the economy in some countries where a "race to the bottom" may be occurring, but this does not seem to be the general case. A more important question may be how international economic competition might be inhibiting a race-to-the-top" (i.e. preventing countries from raising environmental standards). For example, there is some evidence that countries sometimes do not implement new environmental policies out of a fear that their domestic enterprises will lose competitiveness (e.g. European carbon tax; US BTU tax). Enhanced international co-operation is likely to be part of the optimum policy response to this problem.

There are at least three areas where there is work to be done:
- strengthen voluntary codes for environmental best practice by investors,
- reform existing and planned investor protection and promotion agreements so that they do not undermine environmental regulation or the fair and sustainable use of natural resources,
- build a framework of international regulation and coordination to ensure FDI promotes sustainable development.
2. FDI statistics

2.1. FDI worldwide

2.1.1. Introduction

In general, the economists of the early 20th century did not find a need to develop any special theory of foreign investment, or, indeed, to devote much attention to it, apart from heterodox theorists who treated it as imperialism. It is interesting to observe that no small part of the data gathering and some of the most interesting research work today is carried out by individuals and groups in Latin America, whose analytical approach and capacity are indistinguishable from those found elsewhere in the mainstream of financial affairs. Reflective of the newer understandings of what goes on as capital moves transnationally, since the middle to late 1950s, the literature on foreign investment has poured forth in an ever swelling stream, with numerous issues raised by discussions on related topics.

While in recent years capital markets have surged and become by far the most significant source of development finance to developing countries, even in the wake of the Asian crisis, market access has been highly concentrated in a narrow group of middle-income countries. Flows to low-income countries have been rising in recent years, but these too are concentrated in a narrow range of countries. Overall, capital market financing has been less important than FDI, but it too has been characterized by a high degree of concentration among oil and mineral exporting low-income countries.

Beginning in the mid-1980s, more and more developing and transition countries changed their views about foreign investment, switching from a wary, regulatory stance to a welcoming, promoting stance. The response has been phenomenal: amounts of foreign direct investment have grown explosively, with flows to developing countries increasing even faster than those to the industrialized world. Averaging less than US$3 billion per year in the 1970s and less than US$10 billion in the 80s, inflows of FDI to developing countries reached US$198 billion in 1999—more in one year (in real terms) than during the entire decade of the 80s, and 13 times their level ten years earlier in 1987. FDI was in third place among the capital flows to developing countries through the 1960s, 70s and early 80s—aid flows, and then commercial bank loans, were larger. But aid hit a plateau, and commercial lending dried up after the 1982 debt-crisis, while FDI continued to increase. It has been the biggest source of capital for the developing world since 1993.

It is interesting to notice that the flow of direct investment is very much a two-way street among the top investing countries, even though direct investment is more concentrated among source countries than recipient countries. To illustrate this, data show that the top ten exporters of direct investment capital accounted for over 90 per cent of the world total in 1989-93, while the top ten recipients accounted for less than three quarters of reported inflows. The data for the stock of investment, which presumably reflect the accumulation of flows over many years, show similar concentrations. The top ten holders of direct investments abroad in 1995 owned 87 per cent of the world total, while the top ten host countries were the location of about two thirds of the stock. Six of the top host countries were also among the top ten holders.
2.1.2. Most recent statistics

Against a backdrop of sharply increased confidence in the global investment environment, Europe has displaced Latin America as the second most-preferred regional destination for near-term foreign direct investment (FDI), after the United States, according to the latest FDI CONFIDENCE INDEX™ report, released on January 24, 2000 by global management consulting firm A.T. Kearney. Japan also has registered an impressive increase in its overall attractiveness compared with investor sentiment six months ago, according to the A.T. Kearney report. The semi-annual survey of CEOs, CFOs and other top executives of Global 1000 companies reveals that confidence in the global investment environment has risen substantially since July 1999. In fact, 58 percent of senior executives surveyed expressed a more positive outlook concerning the global economy than six months ago and 92 percent plan to maintain or increase their investments abroad.

In spite of Latin America having dropped from second to become the third most-attractive region in the world for foreign direct investment, after North America and Europe. In the long term, however, a majority of CEOs surveyed (57 percent) reported a high to medium likelihood of investing in Latin America, with the economic stability of Brazil being the most important factor influencing their investment decisions. Brazil maintained its ranking as the fourth most attractive investment destination in the world, and is also among the top five destinations inspiring more confidence among investors compared with July 1999.

The United States maintained its position as the most-preferred investment destination for companies from across all sectors and regions of the world. Whether the U.S. can maintain its exceptional growth momentum continues to be the overriding foreign direct investment concern for a full 70 percent of senior executives from global corporations surveyed. In the wake of continued strong U.S. economic performance, American firms appear to represent the most risk-tolerant pool of investors from among the Index sample, based on comparing risk perceptions of U.S. executives with perceptions of those from other regions. Benefiting from the highest sustained growth rate among industrialized countries, it is not surprising that the United States is not only maintaining its position as the single most important source of FDI, but that American investors also appear willing to take risks where others may not.

The trend towards the liberalization of regulatory regimes for foreign direct investment continued in 1999, often complemented with promotional measures. Global FDI grew by one quarter in 1999, according to preliminary estimates released by the United Nations Conference on Trade and Development - UNCTAD, which publishes the annual *World Investment Report*, recognized as the most up-to-date and comprehensive source of information as well as analysis regarding FDI.

The introduction of the euro at the beginning of 1999 has focused attention on the impact of greater European economic integration on patterns and levels of FDI in Europe. European integration over four decades has played an important role in FDI trends in Europe, encouraging investment by firms from outside of the region, promoting consolidation of European industry and help to shape the geographical pattern of production by both European and non-European firms in Europe.

Among the highlights of the preliminary data released by UNCTAD are the following:
- FDI flows to developing countries increased by 15 per cent in 1999, after stagnating in 1998. Of the total flows of an estimated US$198 billion:
• In Latin America, privatization was a major magnet, pulling in 32 per cent more inflows than in 1998. Of this total (an estimated US$97 billion) some US$31 billion went to Brazil, which was the regional champion for the second year in a row. Argentina also was a large recipient, experiencing significant increases in FDI flows in 1999. Latin America and the Caribbean replaced developing Asia as the largest host-developing region for the first time since 1986.

• US$91 billion went to developing Asia (including West Asia), US$40 billion of it to China alone. The Republic of Korea saw a 55 per cent jump to US$8.5 billion, driven once again by M&A.

• In Africa, large increases in FDI inflows were recorded in Morocco and South Africa: for the former, an estimated US$ 2 billion, and for the latter, US$1.3 billion. Africa (including South Africa) is estimated to have attracted US$11 billion in inward investment.- In Africa, large increases in FDI inflows were recorded in Morocco and South Africa: for the former, an estimated US$2 billion, and for the latter, US$1.3 billion. Africa (including South Africa) is estimated to have attracted US$11 billion in inward investment.

- Developed countries attracted an estimated US$609 billion in FDI inflows in 1999, accounting for nearly three quarters of the world's total. The United States and the United Kingdom continue to lead the world in FDI flows. The United Kingdom became the largest investor in 1999, replacing the United States for the first time since 1988. These two countries also represent, for each other, the principal home country as well as host country. Other developed countries recording high levels of FDI flows were France and Germany (both inflows and outflows), Netherlands (inflows), Spain (outflows) and Sweden (inflows). Sweden became the second largest host country in the world for the first time ever. Total flows between the European Union and the United States increased significantly in 1999, after doubling in 1998. FDI inflows to the European Union as a region were an estimated US$269 billion, a 14 per cent rise over the previous year.

- Japan offers a dramatic example of the impact of M&A: its worst post-war recession has led to a sweeping economic restructuring and a more liberal M&A regime that has strongly encouraged M&A and led to an almost quintupling of FDI inflows: from US$3 billion in 1998 to an estimated US$14 billion in 1999. Japanese outflows, also driven by M&A, showed a slight decline, from US$24 billion to an estimated US$23 billion, a decline that might easily have been larger but for a single acquisition, that of the international tobacco business of RJR Nabisco by Japan Tobacco for US$7.8 billion.

- The countries of Central and Eastern Europe, in transition to the market economy, managed to retain a stable flow at about US$20 billion in 1999. Developing countries rebounded from their 1998 stagnation in terms of inward flows, while the United States and the United Kingdom continued to lead in terms of outward flows. The United Kingdom even replaced the United States as the largest outward investor for the first time since 1988. Just to have an idea about how big are the United States numbers, according to figures released by the U.S. Bureau of Economic Analysis on March 15, 2000, FDI flows into the United States were US$282.5 billion in 1999, up from
US$193.4 billion in 1998. FDI outflows were US$152.2 billion, up from US$132.8 billion in 1998.

The above assessment was made by UNCTAD, just before its meeting in Bangkok, Thailand, held from 12 to 19 February 2000, where Heads of State and Government, national ministers, chiefs of key international financial institutions and representatives from civil society and business discussed the ramifications of globalization. The release of these latest figures on FDI flows also preceded the Fifth Annual Conference of the World Association of Investment Promotion Agencies – WAIPA, in Bangkok, the largest international gathering of investment promotion experts, where strategies and techniques to attract foreign investment for development were discussed. UNCTAD estimates that FDI continued its nearly decade-long march upward in 1999 to set a significant new record of global flows: US$827 billion in inward investment (Table 2.1.2.1.). This is a 25 per cent rise over the 1998 figure of US$660 billion, itself representing a 41 per cent increase over the preceding year.

Table 2.1.2.1. FDI inflows by region, 1990-1999 (US$ billions)

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Developed countries</td>
<td>171</td>
<td>115</td>
<td>118</td>
<td>138</td>
<td>141</td>
<td>208</td>
<td>212</td>
<td>276</td>
<td>468</td>
<td>609</td>
</tr>
<tr>
<td>Developing countries</td>
<td>34</td>
<td>43</td>
<td>52</td>
<td>76</td>
<td>100</td>
<td>107</td>
<td>138</td>
<td>172</td>
<td>173</td>
<td>198</td>
</tr>
<tr>
<td>Central and Eastern Europe</td>
<td>1</td>
<td>3</td>
<td>5</td>
<td>7</td>
<td>6</td>
<td>15</td>
<td>13</td>
<td>19</td>
<td>20</td>
<td>20</td>
</tr>
<tr>
<td>World total</td>
<td>206</td>
<td>160</td>
<td>175</td>
<td>220</td>
<td>247</td>
<td>330</td>
<td>363</td>
<td>478</td>
<td>660</td>
<td>827</td>
</tr>
</tbody>
</table>

Source: UNCTAD, FDI/TNC database

* Preliminary estimates
2.1.3. Mergers and acquisitions

The driving force behind these recent increases is cross-border M&A. In the developed world, M&A have become the primary mode of entry into foreign markets, while in developing countries their importance is growing. The reasons for the enhanced role of M&A are in part specifically commercial (e.g., over-capacity and low demand in certain industries), in part strategic (e.g., sharing high investment costs in information technology and high research and development expenditures) and in part related to the policy environment (e.g., the widespread adoption of deregulation and liberalization measures).

Investment that arrives through a merger or an acquisition can differ from a direct investment in some of its consequences for the host country. Over the past ten years cross-border M&A activity has risen fivefold, up from $159 billion in 1990 to $798 billion in 1999. The rise of the mega-deals is demonstrated by the dramatic increase in the average deal value, climbing from $29 million in 1990 to $157 million in 1999. Recent data shows that the value of international cross-border merger and acquisition (M&A) activity rose by 47 percent from 1998 to 1999, up from US$541 billion to a record high of $798 billion, according to a survey published today by KPMG Corporate Finance, a global investment banking adviser. The short-term and long-term consequences of M&A-driven FDI therefore require careful analysis in terms of their impact on development. The KPMG Corporate Finance Survey, the most comprehensive of its kind, represents data compiled worldwide from over 5,000 cross-border mergers, acquisitions and strategic investments announced during 1999. It shows a continuation of the record growth in M&A activity in Europe and North America and the gradual emergence of the Asia Pacific region from a period of recession and restructuring.

The research also found that Western Europe was the world’s leading region for cross-border M&A deals. In 1999 the region announced 73 percent by value ($582 billion compared to $327 billion in 1998) of the world’s cross-border deals, and attracted 45 percent of inward investment value. The Asia Pacific region attracted $56 billion ($52 billion in 1998) in corporate investment from cross-border M&A deals in 1999, against an outward investment of $33 billion, thereby becoming a net buyer of businesses on the international stage. The key buyers in the region were Japan and the US, both having led investment into the region with deals valued at $20 billion each, followed by the UK and France with $8 billion each. Central and Eastern Europe remained out of favor for cross-border M&A deals in 1999, with inward investment rising from only $8 billion in 1998 to $12 billion in 1999. Latin America fared slightly better attracting $39 billion of inward investment during 1999 compared to $36 billion in 1998. Argentina was Latin America’s leading country for inward investment attracting $20 billion, compared to Brazil’s $9 billion. As a set, the volume of investment in global emerging markets (for example, China, Russia, India, Indonesia, Brazil) fell from $35.9 billion in 1998 to $21.6 billion in 1999, in part reflecting corporate investors’ concerns about political stability, corporate transparency and trading incentives in those countries.

In sector terms, the postal and telecommunications industry was again the most active in the global M&A market, with deals worth $159 billion (20 percent of the world’s total) in 1999. The chemical industry was second, completing deals worth $93 billion. The extraction of mineral oil and natural gas ($75 billion), banking and finance ($59 billion)
and the production and distribution of electricity, gas and other forms of energy ($42 billion) were the next most active sectors in 1999.

Table 2.1.3.1., right below, shows the biggest deals that took place last year:

Table 2.1.3.1.  Top 10 worldwide cross-border M&A deals in 1999

<table>
<thead>
<tr>
<th>Bidder name</th>
<th>Target name</th>
<th>Bidder country</th>
<th>Target country</th>
<th>Value US$ billions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Vodafone Group Plc</td>
<td>Airtouch Communications Inc</td>
<td>United Kingdom</td>
<td>United States</td>
<td>69.30</td>
</tr>
<tr>
<td>Zeneca Group Plc</td>
<td>Astra AB</td>
<td>United Kingdom</td>
<td>Sweden</td>
<td>37.70</td>
</tr>
<tr>
<td>BP Amoco Plc</td>
<td>Arco Atlantic Richfield Co</td>
<td>United Kingdom</td>
<td>United States</td>
<td>34.00</td>
</tr>
<tr>
<td>Mannesmann AG</td>
<td>Orange Plc (74,9%)</td>
<td>Germany</td>
<td>United Kingdom</td>
<td>28.54</td>
</tr>
<tr>
<td>Hoechst AG (Acq 53%)</td>
<td>Aventis/JV Rhone-Poulenc SA</td>
<td>Germany</td>
<td>France</td>
<td>22.00</td>
</tr>
<tr>
<td>Repsol Sa</td>
<td>Ypf Sa (85,01%)</td>
<td>Spain</td>
<td>Argentina</td>
<td>15.45</td>
</tr>
<tr>
<td>Deutsche Telekom AG</td>
<td>One-2-One</td>
<td>Germany</td>
<td>United Kingdom</td>
<td>13.60</td>
</tr>
<tr>
<td>Total SA</td>
<td>Petrofina SA (98,8%)</td>
<td>France</td>
<td>Belgium</td>
<td>11.26</td>
</tr>
<tr>
<td>ScottishPower Plc</td>
<td>Pacifcorp</td>
<td>United Kingdom</td>
<td>United States</td>
<td>10.80</td>
</tr>
<tr>
<td>Wal-Mart Stores Inc</td>
<td>Asda Group Plc (77,96%)</td>
<td>United States</td>
<td>United Kingdom</td>
<td>10.60</td>
</tr>
</tbody>
</table>


2.2 FDI in Latin America

In 1980, Latin America attracted 70% of all FDI flows to developing countries. Then, as the crisis-ridden 1980's continued, Latin America lagged and Asia assumed a more dominant role. By 1994, the situation was almost entirely reversed, with Asia attracting 60% of the FDI flows to developing countries. Recent FDI statistics suggest that the pendulum may have begun to swing back towards Latin America again, with U.S. investors in the lead. Importantly, the opinions of corporate leaders appear to concur.

By the end of 1997, a survey showed that 87% of U.S. corporate executives stated that they are more confident in Latin America as a region for investment than they were five years before. This stance appears to be based on their belief that economic and political reforms in the region are genuine and should continue for the foreseeable future. With a more stable environment and business opportunities beckoning, U.S. corporations see Latin America as a region to be given more attention by their site selection and investment managers alike. Even the crisis in Brazil, at the beginning of 1999 seems not to have changed this belief in LA.
Table 2.2.1. FDI inflows to South America and the Caribbean and South, East and Southeast Asia, 1990-1999 (US$ billions)

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</tr>
</thead>
<tbody>
<tr>
<td>Latin America and the Caribbean</td>
<td>10</td>
<td>16</td>
<td>18</td>
<td>18</td>
<td>30</td>
<td>33</td>
<td>46</td>
<td>68</td>
<td>73</td>
<td>97</td>
</tr>
<tr>
<td>South, East and Southeast Asia</td>
<td>20</td>
<td>21</td>
<td>28</td>
<td>50</td>
<td>61</td>
<td>67</td>
<td>80</td>
<td>88</td>
<td>83</td>
<td>84</td>
</tr>
<tr>
<td>Total</td>
<td>30</td>
<td>37</td>
<td>46</td>
<td>68</td>
<td>91</td>
<td>100</td>
<td>126</td>
<td>156</td>
<td>156</td>
<td>181</td>
</tr>
</tbody>
</table>

Source: UNCTAD, FDI/TNC database
* Preliminary estimates

According to preliminary estimates released by UNCTAD\(^{26}\), the amount of FDI into Latin America and the Caribbean as a whole in 1999 increased by 32 per cent from US$73 billion to US$97 billion. The region was the largest recipient among developing countries in 1999, surpassing Asia for the first time since 1986 (Table 2.2.1.).

The increase is largely due to the quadrupling of FDI into Argentina (from US$6 billion in 1998 to US$25 billion in 1999) and continued high FDI flows into Brazil (US$31 billion in 1999 compared to US$28.5 billion in 1998). A significant part of FDI flows into Argentina in 1999 was through M&A, like the acquisition of YPF SA by Repsol SA of Spain with a value of US$17 billion.

Comparing 1998 to 1997, South America as a whole experienced a small drop in the value of cross-border M&A, which went down from US$ 42 billion in 1997 to US$ 35 billion in 1998\(^{27}\). Although most countries in the region recorded sharp falls in M&A deals, a significant increase in Brazil offset the gap. Despite financial turbulence then, Brazil confirmed its status as the region’s biggest target for foreign buyers, with a doubling of inward acquisitions in 1998 to US$ 25 billion. Overall, Brazil accounted for around 70 per cent of total acquisitions in Latin America in 1998, compared with just 30 per cent in 1997.
In 1999, Brazil’s privatization-related FDI increased again: its share in total FDI inflows grew from 22 per cent in 1998 to 28 per cent in 1999. FDI inflows also increased in Chile, Ecuador and Peru due to cross-border M&A. They decreased in Colombia and Venezuela.

According to the UN Economic Commission for Latin America and the Caribbean – ECLAC, in the 1999 edition of its annual report on *Foreign Investment in Latin America and the Caribbean*, there can be no doubt about the impact in the region of globalization and national policies of liberalization and deregulation aimed at facilitating new operations by transnational companies. The share of these companies in the sales of Latin America’s 500 largest companies rose abruptly from 26.6% to 38.7% in the 1990s, while that of local private companies remained static at some 40% and sales by state companies dropped resoundingly from 35% to 19.1%. In sectoral terms, manufactures remained stable at almost 42% of total sales, while services leapt from 30% to 41.2% and primary activities fell from 27.8% to 17.4%.

In terms of modalities of FDI, ECLAC recorded the great increase of M&A during 1998 and 1999, which contrasts with the considerable fall in the value of privatizations. Some 60% of FDI entering the region during these two years went to create new assets and 40% to purchase existing assets. At the same time, mergers and acquisitions were highly concentrated in three countries - Argentina (45.6%), Brazil (26.4%) and Chile (16.5%) - and five of the largest operations accounted for almost half (49%) the total. Of the investment involved in the operations as a whole, 53% was Spanish. Brazil accounted for 62.4% of the privatizations carried out in the region and Argentina 18%. Foreign participation was more diversified in these operations than in mergers and acquisitions, with the United States representing 14.8%, Spain 8.7% and Portugal 8.4%. However, 80% of the total was accounted for by 24 operations, of over US$ 500 million each, while the five largest accounted for 39.5%.

The new all-time record set for FDI in Latin America in 1999 would appear to suggest that the region has managed to overcome most of the negative circumstances affecting investment flows to developing countries. It has been aided in this effort by the simultaneous appearance of new and interesting alternatives for foreign investors, most of which involve the acquisition of existing assets. During 1998-1999, the Asian crisis seems to have had less impact on net FDI inflows to the region than other macroeconomic variables. In the countries of the Latin American Integration Association (LAIA) – the economies most affected by these international disturbances – capital inflows in 1998 rose by 6.3% from their 1997 level, to total US$ 64.465 billion, and are expected to have risen again in 1999, to over US$ 85 billion.

Despite the significant growth of net FDI inflows to Central America and the Caribbean, including also financial centers (Netherlands Antilles, Bahamas, Bermuda, Cayman Islands, Virgin Islands and Panama) and some medium-sized countries (especially Chile), Latin America’s three largest economies continue to be the main magnets for TNCs. During the period 1995-1999, Brazil, Mexico and Argentina received nearly two thirds of the total net inflows to the region.

As a result of the deregulation of Latin American economies – particularly through the privatization of State owned assets – new investment opportunities have opened up in sectors that were previously off limits to private activity, in general, and to foreign companies, in particular. This has prompted an inflow of companies that had not established a significant position in Latin America before, especially in the areas of services, infrastructure and mining. Accordingly, these investors in the region have adopted
another two strategies in an effort to gain access to national markets in the service and infrastructure sectors and gain access to raw material. In the services sector, the size of the local market, the regulatory framework and technological changes have been influential factors in foreign investment decisions. The extent of their influence can be measured on the basis of their contributions to the systemic competitiveness of the economy as a whole, the population’s access to new products and services, and the dissemination of best international practices.

2.3 FDI in Brazil

2.3.1. Recent history

In recent years, in conjunction with the implementation of policies (the Real Plan) aimed at stabilizing, liberalizing and opening up the Brazilian economy, net FDI inflows have grown at an unprecedented rate. Capital inflows surged from about US$ 1 billion in 1990 to US$ 31 billion in 1999, and since 1996 Brazil has been the leading Latin American FDI recipient and the second-largest destination among all the developing countries.

Over the last 50 years, FDI and TNCs have played an important role in Brazil’s economy. Currently, Brazil’s GDP is the tenth in the world (even after the almost 100% devaluation of the real in January, 1999), and its production capacity is complex and relatively sophisticated compared with the patterns of other developing countries. The development of this industrial base is, to some extent, the result of deep and wide-ranging penetration of foreign capital in the Brazilian economy, principally in manufacturing.

Like many nations in the developing world, Brazil for many years followed an inward-looking development model that emphasized the creation of a local industrial base, using tariff walls and other barriers to restrict competition from foreign firms. From the early 1960s until the mid-1980s, Brazil was governed by a military regime that promoted nationalistic policies favoring local investment over foreign investment by TNCs. Despite a relatively unattractive policy framework, foreign investors, lured by the size of the Brazilian market and the country's natural-resource base, were active in Brazil during this period. A recent study conducted by the United Nations Center on Transnational Corporations (UNCTC), for example, showed that Brazil attracted the most foreign direct investment of any developing country from 1980 to 1984.

However, beginning in the mid 1980s, the inward-looking model began to unravel. A chaotic economic environment ensued, the result of high inflation stemming from heavy government spending and foreign borrowing. The plague of hyperinflation and the turbulent effects of shock programs designed to control it led to a decline in Brazil's share of all the foreign direct investment going to developing countries. According to the UNCTC survey, during 1985-1989 Brazil fell from first to fifth, behind Singapore, China, Mexico, and Hong Kong.

In response to both the difficult economic situation and the wave of market-oriented economic liberalization sweeping the developing world, the government of Fernando Collor, who assumed the presidency in 1990, attempted to attract foreign direct investment by opening up the Brazilian economy and forcing local firms to face international competition.

For many years, Brazil's advantages compared to alternative sites—its large local market, relatively advanced industrial base, abundant natural-resource base, and well-
trained labor force—enabled the country to attract significant foreign investment despite restrictive investment policies. As the Brazilian economy expanded, foreign investors earned attractive returns on their investments, which kept them coming. When economic chaos emerged and growth and profit potential declined, foreign investment in Brazil declined as well.

### Table 2.3.1.1. Foreign direct investment in Brazil, 1992-1999 (US$ millions)

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</tr>
</thead>
<tbody>
<tr>
<td>Outflow</td>
<td>169</td>
<td>580</td>
<td>618</td>
<td>1.163</td>
<td>520</td>
<td>1.660</td>
<td>2.609</td>
<td>1.401</td>
<td>232</td>
</tr>
</tbody>
</table>

*Source: Banco Central do Brasil*

*January and February 2000.*

### 2.3.2. Distribution of the FDI

Until the mid-1990s, given the macroeconomic instability prevailing in the country, the TNCs defended their market share mostly by streamlining their local operations without making major investments, and this caused them to fall further behind the leading edge of technology. With the successful implementation of the stabilization program and increasing economic openness and liberalization, the TNCs present in Brazil had to rethink their business strategies in the country and how they fit into their worldwide integrated production networks. Some withdrew, while others felt obliged to restructure and make major investments to defend their market shares. These new investments were designed to support two very different strategies:

- restructuring and modernization of existing installations or construction of new, modern plants, as was the case with automobile assembly plants, for example. In a
number of industries this restructuring and modernization strategy extended throughout the MERCOSUR area.

- An aggressive strategy of acquisition of the assets of local enterprises, intended to strengthen and extend the TNCs’ presence in the Brazilian market, concentrating on their core businesses. In recent years, foreign corporations have generally diversified less, using acquisitions to eliminate or discourage competition, and betting on the potential of the Brazilian and MERCOSUR markets.

### Table 2.3.2.1. Foreign direct investment flows, selected years (US$ billions)

<table>
<thead>
<tr>
<th>Region</th>
<th>FDI annual flows in each period</th>
<th>FDI as a percentage of gross fixed capital formation</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>FDI as a percentage of gross fixed capital formation</td>
<td></td>
</tr>
<tr>
<td>Brazil</td>
<td>1.8 10.5 18.7 28.5</td>
<td>2.2 7.1 11.9</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>15.6 46.2 68.3 71.7</td>
<td>6.3 12.5 16.1</td>
</tr>
<tr>
<td>Developing countries</td>
<td>48.1 135.3 172.5 165.9</td>
<td>5.0 8.4 10.3</td>
</tr>
<tr>
<td>World</td>
<td>180.6 358.9 464.3 643.9</td>
<td>4.2 5.8 7.7</td>
</tr>
</tbody>
</table>


According to ECLAC, since the mid-1990s, Brazilian government authorities have relied on FDI inflows to assist them in achieving three major objectives, relating to external adjustment, adjustment of public accounts and modernization of the production base and services, namely:

- FDI flows should be used to finance the balance-of-payments deficit;
- FDI should be used to help finance public accounts through foreign investor involvement in the privatization of State enterprises;
- foreign investors and TNCs should channel new investments into modernizing the Brazilian production facilities and services to enhance their productivity and competitiveness.

### Table 2.3.2.2. Foreign direct investment stocks, selected years (US$ billions)

<table>
<thead>
<tr>
<th>Region</th>
<th>FDI stocks in each year</th>
<th>FDI as a percentage of gross domestic product</th>
</tr>
</thead>
<tbody>
<tr>
<td>Brazil</td>
<td>25.7 98.8 128.1* 156.8*</td>
<td>11.5 14.4 15.9</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>76.8 255.0 345.9 415.6</td>
<td>10.5 15.1 17.2</td>
</tr>
<tr>
<td>Developing countries</td>
<td>237.2 769.3 1.055.7 1.219.3</td>
<td>9.8 14.1 16.6</td>
</tr>
<tr>
<td>World</td>
<td>782.3 2.789.6 3.436.7 4.088.1</td>
<td>6.9 9.9 11.7</td>
</tr>
</tbody>
</table>


* Estimates. For details, see "Definitions and Sources" in Annex B and Notes in Annexes B1-4 in WIR99.

The response to the new economic context by TNCs with a longstanding presence in Brazil and the reaction of foreign investors to the opportunities offered by deregulation brought a significant increase in the flows. In 1995, 55% of FDI was concentrated in manufacturing, where the TNCs dominated technologically more sophisticated sectors. The
primary sector came with only 1.6% and the services sector with 43.4%. The U.S. had the
largest stock, with 25%, followed by Germany, with 14% and Switzerland with 7%. It must
be noticed that the financial centers had a share of 11%.

Traditionally, FDI in Brazil has targeted the manufacturing sector, with the aim of
capitalizing upon the advantages offered by its big internal market, restrictive commercial
policies and industrial development incentives for certain product lines. As a result, Brazil
is one of the developing countries with the greatest presence of TNCs, with 384 of the
world’s 500 largest TNCs having operations in the country. Since the early 1990s, the
Brazilian economy has been undergoing a wide-ranging liberalization process which has
opened up previously restricted activities to foreign investors. As a result, an increasing
number of “new players” have entered services activities since 1993, and over 50% of total
net FDI inflows were absorbed by this sector in 1998, which thus overtook manufacturing
as the leading FDI recipient (57% of FDI stock as of late 1997).

Noteworthy is the reaction of foreign investors not established in Brazil to the new
opportunities provided by the deregulation of the economy. The massive inflow of
newcomers is especially significant in the service sector, where there had been considerable
restrictions on FDI. The new opportunities attracted not only major TNCs but also others
which were smaller, even in their home markets. For these, entry into the Brazilian market
was the first step in the globalization process. The basic strategy adopted by these new
investors was to purchase existing assets, through two main mechanisms:

- privatization of state-owned assets, in which foreign investors have been
  predominant in the purchase of enterprises in the electrical and
  telecommunications sectors. The modernization of the acquired facilities has
  brought in considerable FDI flows in the form of new assets.
- acquisition of local enterprises affected by the new competitive situation in the
  Brazilian economy, a process which has been particularly intense in the financial
  sector.

The massive arrival of new companies was especially significant in the service sector,
where FDI had often faced serious restrictions. As a result, services displaced
manufacturing as the main destination of FDI, accounting for 57% of such investment by
late 1997. The main strategy adopted by these new investors was the purchase of existing
assets by two principal means:

- buying privatised state companies, such as those in electricity and
  telecommunications, where foreign purchasers dominated;
- acquiring local companies adversely affected by the newly competitive
  conditions of the Brazilian economy, which were especially intensely felt in
  the financial sector.

The above mentioned aspects of Brazil’s recent experience are particularly
important: the significant proportion of the FDI flows that have gone towards transfers of
property and the considerable concentration of such investment in non-tradeable activities.
The effects of all this on the Brazilian economy are uncertain and have triggered fierce
debate. On the one hand, the massive arrival of foreign investors through the purchase of
existing assets could have positive implications for the modernization and improvement of
services, and hence for the country’s systemic competitiveness. Similarly, new patterns of
competition could stimulate the manufacturing sector into integrating the country more
actively into its international production networks. Finally, the large dimensions of the internal market (made even greater by Mercosur), together with better economic prospects, should ensure continuing interest in the country by international investors.

On the other hand, the large FDI inflows into the Brazilian economy are more likely to turn out to be temporary rather than a long-term trend, above all if it is taken into account that the privatization program will come to an end in the next few years. In addition, the preference for services could exacerbate the anti-export bias of industrialization in Brazil, creating greater balance-of-payments difficulties in the future.

2.3.3. Privatization

FDI can play an important role in making a privatization program successful. The inclusion of foreign investors increases the pool of potential bidders with strong financial resources and technical expertise, raising the chances for these enterprises to be transformed into efficient and profitable entities. There are no legal restrictions on the participation of foreign capital in the voting stock of privatized companies, except when there is legislation to the contrary for the specific sector in which the company belongs.

Privatizations in developing countries have been an important element underlying the rapid increase in foreign direct investment to these countries in recent years. Latin America, East Asia, and countries in Eastern Europe managed to attract substantial amounts of foreign investment through the sale of state-owned enterprises to foreign buyers. However, countries with strong privatization programs also witnessed a growth in foreign direct investment inflows that went beyond the direct impact of foreign participation in these sales. The privatization of infrastructure services, in particular, seems to have had a strong effect on the decision making process by foreign investors, advertising a country as a more attractive investment location.

What happens is that foreign investors will not just automatically participate in any privatization. In order to design an attractive privatization program, developing country governments have to take into consideration investor concerns. Political commitment, business orientation, and transparency are fundamental principles of any successful privatization program. Only if every element of the process - from the design of the general political, legal, and institutional framework down to every single step in the actual sales procedure - is based on these principles, can a government expect strong participation by foreign investors.

The extensive program of public utility privatization and the urgent need to upgrade the country’s infrastructure have been decisive in defining the pattern of net inflows. In 1998, this foreign investment trend was greatly reinforced when the doors were open up to investors in infrastructure (telecommunications and electric power distribution) and the financial system. This has led several transnational service providers to include Brazil in their investment and international expansion strategies. The participation of foreign capital in privatizations has been increasing in the current phase of privatization in Brazil. Table 2.3.3.1. gives an overview on investing countries and values.
Table 2.3.3.1. Brazil: Participation of foreign investors, by investing country, 1991-2000 (US$ millions)

<table>
<thead>
<tr>
<th>Country</th>
<th>PND(*)</th>
<th>State privatizations</th>
<th>Telecommunications</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>%</td>
<td>%</td>
<td>%</td>
<td>%</td>
</tr>
<tr>
<td>USA</td>
<td>1.6</td>
<td>8.3</td>
<td>5.7</td>
<td>22.8</td>
</tr>
<tr>
<td>Spain</td>
<td>1.0</td>
<td>0.0</td>
<td>3.0</td>
<td>12.1</td>
</tr>
<tr>
<td>Chile</td>
<td>-</td>
<td>-</td>
<td>1.0</td>
<td>4.0</td>
</tr>
<tr>
<td>Italy</td>
<td>-</td>
<td>-</td>
<td>143.0</td>
<td>0.6</td>
</tr>
<tr>
<td>France</td>
<td>479.0</td>
<td>2.4</td>
<td>90.0</td>
<td>0.4</td>
</tr>
<tr>
<td>Argentina</td>
<td>-</td>
<td>-</td>
<td>148.0</td>
<td>0.6</td>
</tr>
<tr>
<td>Portugal</td>
<td>1.0</td>
<td>0.0</td>
<td>658.0</td>
<td>2.6</td>
</tr>
<tr>
<td>Uruguay</td>
<td>0.0</td>
<td>0.0</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>South Korea</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Sweden</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Japan</td>
<td>8.0</td>
<td>0.0</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Germany</td>
<td>75.0</td>
<td>0.4</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Holland</td>
<td>5.0</td>
<td>0.0</td>
<td>410.0</td>
<td>1.6</td>
</tr>
<tr>
<td>England</td>
<td>2.0</td>
<td>0.0</td>
<td>692.0</td>
<td>2.7</td>
</tr>
<tr>
<td>Canada</td>
<td>21.0</td>
<td>0.1</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Belgium</td>
<td>880.0</td>
<td>4.5</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Other</td>
<td>157.0</td>
<td>0.8</td>
<td>350.0</td>
<td>1.4</td>
</tr>
<tr>
<td>Foreign Participation</td>
<td>3.3</td>
<td>16.6</td>
<td>12.3</td>
<td>48.8</td>
</tr>
<tr>
<td>Total</td>
<td>19.7</td>
<td>100.0</td>
<td>25.2</td>
<td>100.0</td>
</tr>
</tbody>
</table>


(*) National Privatization Program.
3. FDI statistical methodologies around the world

3.1. Some prior considerations

Driven by technological change, global competition and the ongoing liberalization of markets, international direct investment plays a key role in the process of global economic integration. Reliable and up-to-date statistics are essential for a meaningful interpretation of investment trends for the purpose of policy analysis and decision. Internationally comparable data makes it possible to measure the degree of economic integration and competitiveness of markets.

Most developing countries today consider FDI an important channel for obtaining access to resources for development. However, the economic effects of FDI are almost impossible to measure with precision. Each TNC represents a complex package of firm-level attributes that are dispersed in varying quantities and quality from one host country to another. These attributes are difficult to separate and quantify. Where their presence has widespread effects, measurement is even more difficult. There is no precise method of specifying a counter-factual – what would have happened if a TNC had not made a particular investment. Thus, the assessment of the development effects of FDI has to resort either to an econometric analysis of the relationships between inward FDI and various measures of economic performance, the results of which are often inconclusive, or to a qualitative analysis of particular aspects of the contribution of TNCs to development, without any attempt at measuring costs and benefits quantitatively.

When international capital movements are studied, the flows of capital are usually measured net, as the difference between outflows and inflows, rather than by examining outflows and inflows separately. That is partly out of necessity, for lack of gross flow data. Flows of direct investment capital are an exception to this netting out of outward and inward flows. For many countries, data are available separately for outward and inward flows. The outward flows are measured as the flows involving firms based in the reporting country, although these firms can, at times, repatriate their foreign investment, producing negative outward flows. The inward flows represent the activity in the country of firms based in other countries. The division reported now by the IMF, following this practice, is between “investment abroad” and “investment in” a country. The scope of this paper is focused on the second case.

A possible way to explain the different treatment of direct investment, aside from the problems of collecting data, is that direct and portfolio investment are related differently to the financial markets in home and host countries. Direct investment flows do not enter any general financial market. They are internal to each firm, and an inflow is not simply offset by an outflow. Each flow brings something different to a country because it is attached to a specific firm. Thus, a comparison of net direct investment flows with aggregate net international investment misses much of the significance of direct investment. It is obvious that there is an urgent need to improve measures and statistics in a worldwide scale and that means Brazil must follow this trend.

Despite their limitations, official statistics on FDI are highly important source of data, and international institutions’ efforts to promote a methodological convergence in this field should therefore be supported in order to improve the quality of this information. Destination countries can also help by upgrading their national FDI information systems. International institutions and official agencies are working to bring this about, but in the
meantime the experts have to interpret the available information with the tools currently at their disposal.

Solutions have to be found for the serious problems affecting official statistics on FDI. Until an appropriate methodological convergence is achieved, part of the solution lies in seeking out supplementary information from other sources in the business community, academic circles and the media (particularly the specialized press).

3.2. Basic guidelines for statistics on FDI

Official figures on FDI abound, but unfortunately they are also inconsistent and their analysis often proves difficult. Naturally, it is impossible to gain a full understanding of FDI as an economic phenomenon if the official information sends out mixed or blurred signals. The available statistics on FDI worldwide, which are from ideal, come mainly from three sources:

- there are statistics from the records of ministries and agencies which administer a country’s laws and regulations on FDI. The request for a license or the fulfillment of notification requirements allows these agencies to record data on FDI flows. Typically, re-invested earnings, intra-company loans, and liquidations of investment are not recorded, and not all notified investments are fully realized in the period covered by notification.

- There are FDI data taken from government and other surveys which evaluate financial and operating data of companies. While these data provide information on sales (domestic and foreign), earnings, employment and the share of value added of foreign affiliates in domestic output, they often are not comparable across countries because of differences in definitions and coverage.

- There are data taken from national balance-of-payments statistics, for which internationally agreed guidelines exist in the fifth edition of the IMF Balance of Payments Manual. It is also possible to get information from the Organization for Economic Cooperation and Development (OECD).

Many countries have not yet fully implemented the IMF guidelines (in particular, re-invested earnings and inter-company transactions are not always covered), which impairs the comparability of FDI data across countries. In addition, a large number of developing countries do not provide FDI data. Despite recent improvements, more efforts at the national level are needed before comparable and reasonably comprehensive FDI data will be available at the global level.

The IMF compiles information on FDI based on balance-of-payments categories and definitions for the various types of investment flows (equity capital, reinvested earnings and intra-company liabilities). This information is particularly useful since the participation of so many central banks which apply the system used in the IMF Balance of Payments Manual means that the statistics are comparable internationally. However, since the IMF information is not desegregated on a geographical or sectoral basis, its analysis is difficult.

OECD prepares statistics on the source and destination by sector of its member countries’ FDI flows. This avoids the problems caused by the lack of desegregation of IMF data by geographical destination and sector, but it creates other difficulties, since the information is confined to OECD members (Brazil is not a member country of OECD) and thus affords only the perspective of investor countries. Moreover, the information is not entirely comparable (for example, some countries do not provide data on reinvested
earnings). In addition, there are minor problems associated with the national accounting practices of OECD members (for example, the definition of controlling interest in a company). Although it is true that the bulk of FDI flows do come from OECD countries, recent world trends indicate that a growing percentage of FDI flows originate in countries that are not members of that organization.

Many non-OECD countries, as Brazil, have their own sources of FDI information, such as central banks, institutions that promote FDI inflows to the country, and some government ministries, which present information basically from the point of view of FDI destination countries. Differences in national accounting practices pose major problems which make international comparisons less meaningful, however. Significant differences also exist with regard to the registration and inclusion of portfolio investment, syndicated loans and the availability of official data on reinvestment.

In May, 1997, the IMF and the OECD launched the Survey of Implementation of Methodological Standards for Direct Investment (SIMSDI), after consulting with the IMF Committee on Balance of Payments Statistics and the OECD Working Party on Financial Statistics. The survey is a comprehensive study of data sources, collection methods, and dissemination and methodological practices for FDI statistics. Similar surveys were conducted in 1983 by the OECD concerning its member countries, and in 1991 by the IMF’s Working Party on Measurement of International Capital Flows (the Godeaux Report), the latter concerning 38 of the largest reporters of FDI statistics. 114 countries replied to the 1997 survey, a very encouraging response rate indicating the importance that national compilers attach to these data.

The results of the survey, conducted by the IMF Statistics Department and the OECD Directorate for Financial, Fiscal and Enterprise Affairs, provide an essential tool for FDI analysts and policy makers while preparing the ground for improving compliance with the agreed international standards of FDI data collection set by IMF and OECD. The conclusions and the analysis were based on the information for ninety-six countries collected through a comprehensive survey on methodological standards and data collection methods organized under the auspices of the IMF Committee on Balance of Payments Statistics and the OECD Working Party on Financial Statistics. The results of the survey allowed the OECD to organize a Workshop on FDI Statistics, in March 1999, to undertake further work on FDI methodology and data collection methods, to which IMF and other international agencies were closely associated. Besides a summarized report that can be found at the OECD’s web site, the complete details of the survey are recorded in an Internet database that can be accessed by officials from IMF, OECD and international organizations.

3.3. Procedures in the USA

3.3.1. The “Foreign Investment Act”

Although there has been a lot of effort among countries around the world to derive common procedures regarding FDI statistics, this section will focus in the United States, considered a serious benchmark worldwide. Up-to-date procedures on other countries, developed and developing, were object of a recent workshop and seminar sponsored by OECD, which took place in Estonia, in 1999. Besides the European Central Bank itself, several developed countries, including Germany, France, Italy, and Canada, and several
economies in transition as such as Latvia, Estonia and Lithuania, presented their methodologies and participated in the discussions. For reasons of scope and space, those will not be investigated in this paper, but the reader may find it useful to have a look into the references[13].

The Act known as the “International Investment and Trade in Services Survey Act[44]”, rules the issues related to collecting regular and periodic information on international investment and trade in services. Through it, the United States Government is authorized to collect limited amounts of information on US investment abroad and foreign direct investment in the US. As by the time of its publication, in the 1970s, there was already some concern about the effects of international investment on the US economy. International efforts to obtain information on the activities of TNCs and its consequences should be driven to evaluate accurately the potential consequences of international investment flows inward and outward the US. The Congress stated that the lack of sufficient information on such investment could hide its effects on the national security, commerce, employment, inflation, general welfare and foreign policy of the country.

The existing estimates of international investment were collected under existing legal authority and were limited in scope, based on outdated statistical bases, reports and information which were insufficient for policy formulation and decision-making. Besides providing authority to the President to collect information on international investment, it stated that analysis of such information should be provided to the Congress, the executive agencies and the general public. It also stated that the information should be obtained with a minimum burden on business and other respondents and with no unnecessary duplication of effort, consistent with the national interest in obtaining comprehensive and reliable information. The Act presents some definitions of terms related to foreign investment, which are a standard for the purpose of gathering data and performing statistics.

The President is authorized to conduct a regular data collection program to secure current information on international capital flows and other information related to international investment, including (but not limited to) such information as may be necessary for computing and analyzing the United States balance of payments, the employment and taxes of United States parents and affiliates, and the international investment position of the United States.

Studies and Surveys must also be conducted to prepare reports in a timely manner on specific aspects of international investment which may have significant implications for the economic welfare and national security of the United States. The Act states that the President must also recommend necessary improvements in information recording, collection, retrieval, and statistical analysis and presentation. Reports must be sent periodically to several institutions in the Government. Benchmark surveys must be conducted every five years, identifying the location, nature, and magnitude of, and changes in total investment by any parent in each of its affiliates and the financial transactions between any parent and each of its affiliates. In addition to the benchmark surveys, information must be gathered annually through compilation of available data.

The information may come from the balance sheet of parents and affiliates and related financial data, income statements (including the gross sales by primary line of business of parents and affiliates in each country they have significant operations, and related information regarding trade between a parent and each of its affiliates. Besides collection of employment data (number of employees, compensation, by origin country, industry and skill level), information must gathered about tax payments and the total
amount of research and development expenditure and the compensation for the transfer of technology between parents and affiliates.

The Act also stated that the President should conduct a study of the feasibility of establishing a system to monitor FDI in agricultural, rural and urban real property, including the feasibility of a nationwide multipurpose land data system.

Concerning the confidentiality from the government officials dealing with the information, any person who willfully violates the confidentiality on the data is subject to a fine of US$ 10,000, in addition to other penalty imposed by law. This value also applies to the fine on whoever fails to furnish any information required under the Act. A like fine, imprisonment, or both may punish any officer, director, employee, or agent of any corporation who knowingly participates in such violation, upon conviction.

### 3.3.2. The work developed at the BEA and the IID

The agency responsible for statistics of FDI in the United States is the Department of Commerce, through its Bureau of Economic Analysis (BEA), with an annual budget of approximately US$ 45 million. Among its several divisions, there is the International Investment Division (IID), which, with a staff varying from 85 to 95 people, collects and analyzes data on U.S. direct investment abroad (USDIA), foreign direct investment in the United States (FDIUS), and selected services transactions with unaffiliated foreign persons. The data are published in the Survey of Current Business (SCB) or other publications. Some of them are mentioned below and they can be found at BEA’s site in the Internet.

**Figure 3.3.2.1. Structure of the International Investment Division - BEA**

![Structure of the International Investment Division - BEA](image)

The IID’s work in terms of FDI, which may considered a benchmark for the Brazilian Central Bank in FDI statistics and reporting, regularly publishes different data and articles, divided into five major areas:

- **Direct Investment Position and Related Balance of Payments Flows**: Preliminary annual estimates are published in the summer of the year following the year covered; revised estimates are published a year later. Written analyses of data for the most recent year are based on preliminary estimates. Prior to 1996, quarterly estimates of the flows (but not the position) were published, in limited detail, in
the U.S. international transactions articles in the March, June, September, and December Survey of Current Business (SCB) issues. Beginning in 1996, these articles have been appearing in the April, July, October, and January SCBs. The most recent include:

* The International Investment Position of the United States at Yearend 1998 July 1999

- **B. Operations of U.S. Affiliates of Foreign Companies:** Data are from an annual sample survey of foreign direct investment in the United States. The survey collects financial and operating data of the U.S. affiliates of foreign direct investors, such as balance sheets, income statements, employment and compensation of employees, trade in goods, and selected data by State. The first annual survey covered 1977. Data are preliminary when first published; revised data are published a year later. Articles published before those listed below presented only reported sample data. The listed articles present universe estimates derived by linking the sample data reported in the annual survey to the preceding benchmark survey. Some examples are:

  * Real Gross Product of U.S. Companies' Majority-Owned Foreign Affiliates in Manufacturing April 1997

- **Establishment Data from BEA-Census Link:** Detailed establishment data for U.S. affiliates of foreign companies obtained from a project that links Bureau of Economic Analysis (BEA) enterprise, or company, data on foreign direct investment in the United States with the Census Bureau's establishment data for all U.S. companies. The data are presented by detailed industry, by country of ultimate beneficial owner, and by State.

- **U.S. Business Enterprises Acquired or Established by Foreign Direct Investors:** Data are from an annual survey of U.S. businesses newly acquired or established by foreign direct investors during the year. The first survey covered 1979. Data are preliminary when first published; revised data are published a year later. Recent publications include:

  * Regional Patterns in the Location of Foreign-Owned U.S. Manufacturing Establishments May 1999
  * The Domestic Orientation of Production and Sales by U.S. Manufacturing Affiliates of Foreign Companies April 1998
  * BEA Statistics on U.S. Multinational Companies March 1995
  * Differences in Foreign-Owned U.S. Manufacturing Establishments by Country of Owner March 1996

- **Benchmark Surveys and Related Articles:** Benchmark surveys are periodic surveys of the universe of foreign direct investment in the United States. In addition to the direct investment position and related capital and income flows, they cover a wide range of operating and financial data of U.S. affiliates of foreign direct investors, such as balance sheets, income statements, external financing, employment and compensation of employees, trade in goods, and selected data by State.

  * Foreign Direct Investment in the United States: Preliminary Results from the 1997 Benchmark Survey August 1999
The following data on FDI in the US, most of it for each year from 1994 to 1998, is already available through the Internet, at the BEA’s site (look for BEA in Organizations, at the end of this paper), making it much easier for the general public and private and public organizations to have access to them:

* Detailed annual balance of payments and position estimates
* Capital flows- annual and quarterly tables
* Capital flows- detailed annual country by industry tables
  - Total capital / Equity capital / Intercompany debt / Reinvested earnings
* Income-detailed annual country by industry tables
* Position on historical-cost basis
* Country detail for position, capital flows, and income
* Industry detail for position, capital flows, and income
* Selected financial and operating data by State, as such as
  - Number of affiliates / Gross property, plant and equipment / Commercial property /
  - Employment / Manufacturing employment
* Historical financial and operating data

About a year ago, the United States Department of Commerce published a book containing most of its experience in collecting data and preparing statistics on FDI. It is called “International direct investment: Studies by the Bureau of Economic Analysis” and contains the methodologies that have been used for the last ten years. It brings together a number of key studies by the Bureau of Economic Analysis (BEA) on U.S. direct investment abroad and foreign direct investment in the United States. The studies cover such topics as the characteristics of multinational companies, including their profitability, productivity, and sourcing patterns; measures of direct investment that are valued in current-period prices; and supplemental balance of payments frameworks that incorporate information on ownership from BEA's direct investment surveys. These studies were originally published in the Survey of Current Business, BEA's monthly journal. This publication also includes users' guides to BEA's statistics on direct investment and detailed methodologies from BEA's benchmark survey publications on foreign direct investment in the United States and U.S. direct investment abroad. The contents of this volume are to become a very useful when the Brazilian Central Bank starts its planning for its next census of foreign capital.

Appendix 1 contains the current reporting requirements for foreign direct investment in the United States, as of March 1999. The forms for the “1999 Annual Survey of Foreign Direct Investment in the United States” and the “1997 Benchmark Survey of Foreign Direct Investment in the United States” can be found at BEA’s site.
3.4. FDI statistics in Brazil

3.4.1. The work of FIRCE in Brazil

The Brazilian Central Bank, under the Directorate of International Affairs, has the Department of Foreign Capital, also known as FIRCE. Its purpose is to ensure strict compliance with the norms covering the flows of foreign capital inward and outward Brazil, as such as loans, imports financed over a year and investment/reinvestment operations. Besides registering the operations, it also authorizes financial remittances linked to loans, profits, return on capital, technical assistance, after-sales assistance and royalties. FIRCE has a national presence through its regional offices, which perform task driven to the public and the firms. At its headquarters in Brasilia, FIRCE has several teams, one for each of the major areas mentioned above.

Concerning FDI, there are two teams of highly skilled professionals: the first has specialists in foreign investment (direct, abroad and portfolio) and formulates regulations and procedures, acting as an nationwide advisory service in any questions related to FDI; the second performs all the work related to developing and maintaining information systems and data collecting and statistics regarding capital flows, and provides specific information on FDI. One of its major achievements in the last years has been the complete automation of the procedures required for registering operations related to imports financing (operational since 1998) and investment (available on April 2000), which have on-line access by the clients. This group plays a vital role in FIRCE’s orientation towards consolidating its status as an information center known as “the” most reliable source of FDI statistics in Brazil. The efforts to reduce the typical bureaucracy and its related work are paying off due to the cost reduction related to paperwork elimination and improved efficiency, allowing real-time reports on statistical data.

According to FIRCE’s strategic planning for the year 2000, one of its main responsibilities is the elaboration and spreading of information related to all foreign capital stock and flows with the rest of the world. That means managing all the information systems and databases related to those stocks and flows, and dealing with special requests from several institutions: government agencies, the House of Representatives, the Senate, the Ministries, international organizations, embassies, private and public enterprises, universities and research centers, individual foreign investors, specific national and foreign associations and the public in general. One of the most praised results in providing accurate information on capital flows resides on identifying operations which are suspect of being involved in financial crimes, hidden behind illegal transactions among Brazil and other countries (mainly financial centers).

3.4.2. The 1995 Census of Foreign Capital

FIRCE has been spending a lot of effort on FDI statistics since its creation. A major achievement was the 1995 Census of Foreign Capital. Brazilian legislation on foreign capital in 1962 (Law no. 4.131, Article 55) provides for periodic censuses of the activities of foreign companies in the country. The first such census was conducted by the Central Bank only in 1996, and the preliminary results were published in May 1998. The Census covered a sample of 6,322 companies (as a comparison, Canadian statistics have a sample of 6,821 companies), in which non-residents controlled at least 10% of the common or
voting stock, or 20% or more of total capital. The national system of classification of economic activities used by the Brazilian Geographical and Statistical Institute (IBGE), the official statistics agency in Brazil, classifies companies by industry and identifies 57 branches of activity.

In addition to statistics for the 6,322 companies with non-resident shareholders, the Census revealed findings for 4,902 companies with majority foreign ownership. The monetary values were expressed in reais and converted into United States dollars using the average selling rate for the dollar in 1995. First-line indirect ownership was assessed on the basis of the percentage of shares held by non-residents. This way, the holding companies of foreign groups in Brazil and their networks of affiliates and subsidiaries were identified. The Census did not take into account second-line or more indirect foreign investment. The industry under which a company was categorized was based on the product that contributed the most to the company’s sales.

The statistics on cumulative foreign capital related to December 31, 1995. The figure were broken down by industry and by FDI source country. Concerning these source countries, financial centers (tax havens) which conceal the true origin of the investment posed a problem that persists up to date. The form sent to companies called for a significant degree of detail on the company’s assets and liabilities, earnings, other accounting information, data on foreign trade and number of employees.

According to the Census, the Brazilian companies with foreign investors had about U$ 94 billion equity, of which US$ 49 billion (52%) belonged to foreigners. Their total assets were US$ 245 billion, with revenues of US$ 199 billion. A rough estimate shows that they were then responsible for about 10% of Brazil’s GDP. Exports were US$ 22 billion (47% of total). For each US$ 1,000 generated as added value inside the country, these companies exported US$ 275 dollars and imported US$ 242. As a comparison, the rest of Brazil had an average of US$ 33 in exports and US$ 42 in imports. These companies were responsible for 1,447,000 direct jobs, about 9% of the total employment. They produced an added value of US$ 55,000 per employee while the country average was US$ 49,000.

3.4.3. Suggestions on a framework for FDI statistics in Brazil

It is not in the scope of this monograph to come up with a comprehensive framework for the collection, compilation and dissemination of FDI statistics in Brazil. Nevertheless, some ideas must be taken for discussion, in order to raise the debate among the interested parties and come up with effective suggestions for improving the present procedures adopted by FIRCE. Based on previous experience and recommendations from several countries and supra-national organizations, as such as the World Bank (specially its Foreign Investor Advisory Service), it is possible to suggest some actions to be considered by FIRCE in its strategic planning.

Traditionally, most countries have produced statistics on foreign investment for one or more of the following purposes, to:

- classify international investment transactions according to the nature of ownership of the investments as part of the country's balance of payments accounting;
- classify assets abroad and liabilities to foreigners according to the nature of ownership; and
identify foreign control of domestic corporations for policy purposes.

Attitudes toward foreign direct investment have changed significantly since the early 1980s, as a result of decreasing flows of other types of foreign capital, such as commercial bank loans and foreign aid, and the increasing globalization of the world economy. Consequently, FDI has become increasingly important as a source of capital, particularly for developing and transition economies. Many countries are liberalizing their economies and implementing policy changes to participate more fully in the internationalization of production.

As a result, the importance of accurate and timely statistics on the volume, sectoral composition and sources of FDI has increased significantly at the national and international level. Accurate information on FDI flows provides important inputs into the decision-making processes of investors as well as the policy decisions of national governments. This information is also used extensively by international agencies, such as the World Bank and International Monetary Fund (IMF) for monitoring balance of payments and developing economic assistance strategies. Investors and policy makers require a range of information, including information on the amount, country of origin, location, employment generation, and sector of foreign investment.

One of the main worries of the Brazilian government and private sector is the continuity of FDI flows in 2000, maintaining the 1999 volumes even after most of the privatization has already been performed. The recent creation of an experimental investment promotion agency (discussed in more detail on Chapter 4) is a sign of times. From an investment promotion policy and strategy perspective, statistics on the economic characteristics of and trends in FDI are particularly important for:

- National economic policy - to assess the costs and benefits of FDI and its economic impact in areas such as employment and capital formation;
- Infrastructure and resource planning and development;
- Cross-country comparison - to assess the level of FDI attracted in relation to competing countries; and
- Investment promotion - to analyze FDI data on approvals and realizations by source country and sector in order to devise effective investment promotion strategies.

Considering the planning and action for the next Census of Foreign Capital needed and expected to take place in the year 2001, based on data from December 31, 2000, in a broader basis than the 1995 Census, the primary objective of FIRCE could be to develop a consistent framework for the definition, collection, and dissemination of foreign direct investment statistics that be consistent with the standard international definitions and the expectations and recommendations of the several clients to such kind of information. In order to accomplish this objective, it could be necessary to review the existing systems and to understand the current legal, institutional and other issues, which affect the data collection methodology and the quality of the data collected. On the basis of this review and benchmarking effort, recommendations could be made for the technical and institutional framework taking into account the experiences of other countries and the relevant best practices mentioned in this work.

Of course, the clients must give the basic directions and the final word about the effectiveness of the proposed framework. Since there are a number of agencies involved in the collection of various foreign investment-related statistics and an even wider range of
users, one of the key elements for the success of this type of project would be the active collaboration and participation of representatives of the major users and producers of foreign investment data. In order to facilitate such collaboration and participation, the establishment of a high-level inter-agency committee would be recommended. The role of this committee, lead by FIRCE or the Brazilian investment promotion agency, would be to provide leadership in the process of developing and implementing an effective framework for the collection and dissemination of foreign investment statistics.

While the public policy and balance of payments applications comprise the primary uses for foreign investment statistics, the interest of the private sector, including domestic and foreign investors, in these data is often overlooked. More importantly, since the private sector is the ultimate source of information on foreign investment statistics, it is also recommended that the inter-agency committee include a representative of an appropriate private sector organization. This inter-agency committee should include, at a minimum, representatives of the national statistical agency (IBGE), the Brazilian Central Bank, the national investment promotion agency (and even the States own agencies), and private sector organizations which represent domestic and foreign investors. These could be the National Confederation of Industries (CNI), the National Confederation of Commerce (CNC), the National Confederation of Agriculture (CNA), the Ministry of Industry and Commerce (MIC) and the Ministry of External Relations (MRE).

The main elements of the project could be grouped into two phases - review and report preparation, and implementation, as follows:

**Phase I**
- Workshop for members of the inter-agency committee to discuss the objectives of the project; the concepts and definitions of foreign investment; and the sources and uses of the data.
- Field work for the review of the existing system for the collection and dissemination of foreign investment statistics. The major areas of focus would include foreign investment data sources and needs, definitions and classification of data, methods of collection, dissemination, and inter-agency collaboration.
- Preparation of the FIRCE report. The report would include an analysis of the present system, recommendations on the framework for the collection and dissemination foreign investment statistics that are consistent with the standard international definitions, and recommendations on technical assistance and training for implementation.

**Phase II**
- A workshop would be conducted to present the findings and recommendations of the report, and to discuss the possible implementation follow-up. The FIRCE team to the selected staff from the implementing agencies would also conduct training.
- Design and implementation of a test data collection exercise by FIRCE, including the analysis of the results.
- Working session to review the results of the test data collection exercise and to discuss the implications for broader implementation of the framework.

Experts from supra-national organizations, as such the World Bank (and IFC plus FIAS), IMF, OECD, and foreign central banks and foreign national statistics agencies could be invited to give their specific views and contributions to this project, either by attending the workshops, making lectures and giving suggestions. In an optimistic approach, and
depending on the availability of resources and sponsors, Brazil could even take advantage of its exceptional situation as a major receiver of FDI and promote an international seminar on FDI statistics and promotion, to be held on the second semester of 2000.

4. FDI: promotion policies

4.1. Regulation and liberalization

The strong expansion of FDI flows in the 1990s has been driven by several interrelated factors: rapid technological change, trade and investment liberalization at a national, regional and global level, privatization, deregulation, demonopolization and the switch in emphasis by firms from product to geographical diversification, involving a more balanced global distribution of production and sales for each company. A large number of stock market listings have also facilitated the sale of domestic companies to foreign investors.

These factors interact at various levels, as policy reform and technological change bring greater competition at a global level, which in turn drives firms to expand abroad and to invest in newer technologies. Governments in turn respond by trying to increase their attractiveness to foreign direct investors through further liberalization and reform. While this process is mutually reinforcing, it is not self-perpetuating. It relies on the continued willingness of national governments to pursue open and non-discriminatory policies. The upward trend in FDI flows could also be interrupted by a decline in global growth. Like any form of investment, FDI is affected by the business cycle. Slower growth in home countries reduces investor profits at home which could have been used for acquisitions at home and abroad.

The recent trend to more open investment policies has been particularly evident in the removal or relaxation of regulatory barriers to the entry of FDI. Screening procedures involving prior authorization have been eliminated or reduced in scope. Closely related is the liberalization of sectoral restrictions on the entry of foreign investment and of limitations regarding foreign shareholding in local companies. There has also been a shift away from the imposition of performance requirements and a liberalization of regulations concerning the transfer of funds. In addition, there has been increasing acceptance of standards of non-discriminatory treatment of foreign investors and of international standards on matters such as compensation in case of expropriation. Finally, international arbitration mechanisms for the settlement of disputes between foreign investors and host states have gained widespread acceptance.

At the same time, there are several qualifications to this liberalization trend. First, the trend has not been homogeneous and significant differences between foreign investment regimes persist. Second, virtually all countries maintain some restrictions, often of a sectoral nature, on the entry of foreign investment. In this connection, an issue that has attracted attention is the existence of reciprocity requirements with regard to the entry and treatment of foreign investment. The liberalization of national laws and regulations has been accompanied by a rapid proliferation of intergovernmental arrangements dealing with foreign investment issues at the bilateral, regional and multilateral levels. Unilateral liberalization of national legal frameworks has not been found sufficient, and states around the world have increasingly recognized the crucial importance of international commitments to securing a stable and predictable legal environment for FDI.
At the regional and interregional levels, rule-making activity on FDI continued to be intense in all regions, mainly in connection with the creation or expansion of regional integration schemes, and typically involving rules for liberalization and protection of FDI. Under the discussion about a Multilateral Agreement on Investment, the question of governance in international business transactions has been a recurrent subject in discussions and work related to international instruments in recent years. Table 4.1.1. provides an overview on recent national regulatory changes. The World Investment Report-1999 does not provide a clear distinction between what is more or less favorable to FDI.

Table 4.1.1. National regulatory changes, 1991-1998

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<td>Number of regulatory changes, of which:</td>
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<td>101</td>
<td>108</td>
<td>106</td>
<td>98</td>
<td>135</td>
<td>136</td>
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<tr>
<td>Less favorable to FDI**</td>
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<td>0</td>
<td>1</td>
<td>2</td>
<td>6</td>
<td>16</td>
<td>16</td>
<td>9</td>
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Source: UNCTAD, WIR-1999, table IV.1, p.115

* Including liberalizing changes aimed at strengthening market functioning and increased incentives
** Including changes aimed at increasing control and reducing incentives

A central theme which emerges from country studies is that the effectiveness of a given policy is not constant over time. Some host countries were able in the past to attract inward investment by offering a large and protected market. Both Argentina and Brazil received substantial inflows of direct investment in the early years of import substitution, only to see their share of developing country inflows fall precipitously in the 1980s. Market saturation and the lack of dynamism in the local economy as a result of protection eventually places a limit on the future growth of inflows as TNCs gravitate towards more dynamic markets. Trade and investment liberalization in Brazil, as part of more general economic reforms, have reversed this trend in the 1990s.

The same decline in effectiveness can be seen in terms of policies designed to maximize the potential benefits from inward investment. Many host countries made use of performance requirements in the past, such as exporting requirements or technology transfer agreements. As foreign affiliates of TNCs become more oriented towards global or regional markets and hence less dependent on the domestic market and as the number of countries eager to attract FDI grows, the tolerance of foreign investors for barriers and restrictions on their operations is likely to be much less than in the past. In this sense, the cost of investment restrictions has risen.

Many of the remaining barriers to inward investment were erected at a time when foreign firms were investing in economies distorted by trade barriers, a lack of effective competition in product markets, under-developed financial markets and by many other policies associated with import substitution. In this environment, host countries sometimes justified restrictions on inward investment on the basis of the theory of second best which argues that liberalization in one area in the presence of distortions elsewhere may make the economy worse off. In the more competitive environment in many host countries today as a result of roughly a decade of economic reforms, many restrictions are at best ineffective and at worst counter-productive.
The policy environment matters not just for its effect on FDI inflows but also because of the way it influences the potential benefits from those inflows. In the import-substituting environment found in many host countries in the past, the gains from FDI tended to be disappointing, particularly in the area of technology-transfer. After a decade of economic reforms, host countries are better placed to realize the full benefits from inward investment than they were in the past. These benefits could be further enhanced as the process of liberalization continues.

4.2. Policies toward FDI

Since the 1980s, many developing countries have begun to change their policies toward foreign direct investment. Several countries have shifted from restrictive policies that reflect skepticism about the advantages of such investment to policies that seek to attract increasingly larger amounts of foreign investment. The changes in attitudes toward foreign investment have been accompanied by changes in the institutional arrangements by which governments manage their relations with foreign investors. According to the Foreign Advisory Service-FIAS, at the World Bank, most changes have been significant, yet in a wide range of cases these newly configured institutions have not succeeded in accomplishing the various goals that typically have been assigned to them. The fact is that the rhetoric of change has outrun the reality.

Policies designed to attract investment have various aims:
- to increase the quantity of foreign investment directly;
- to increase the quantity of foreign investment indirectly by, for instance, improving the country's investment image;
- to increase the quality of foreign investment directly or indirectly by targeting specific types of investor; or
- to increase the number of firms competing to invest in a specific project. Research has shown that an increase in the number of firms competing to invest in a project is likely to lead to improvements in the terms and conditions of agreements negotiated by host governments because of the resultant increase in the bargaining power of the host government.

Usually, government policies on FDI need to counter two sets of market failures. The first arises from information or coordination failures in the investment process, which can lead a country to attract insufficient FDI, or, the wrong quality of FDI. The second arises when private interests of investors diverge from the economic interests of host countries. This can lead FDI to have negative impacts on development, or it may lead to positive, but static benefits that are not sustainable over time. Private and social interests may, of course, diverge from any investment, local or foreign: policies are then needed to remove the divergence for all investors. However, some divergence may be specific to foreign investment.

While TNCs offer the potential for developing countries to access capital, technology, management techniques and external markets, this does not necessarily mean that simply opening up to FDI is the best way of obtaining or benefiting from them. The occurrence of market failures mentioned above means that governments may have to intervene in the process of attracting FDI with measures to promote FDI generally or measures to promote specific types of FDI. Furthermore, the complexity of the FDI package means that governments face trade-offs between different benefits and objectives.
For instance, they may have to choose between investments that offer short as opposed to long-term benefits: the former may lead to static gains, but not necessarily to dynamic ones. FDI may differ from local investment because the locus of decision-making and sources of competitiveness in the former lie abroad, because TNCs pursue regional or global competitiveness-enhancing strategies, or because foreign investors are less committed to host economies and are relatively mobile. Thus, the case for intervening with FDI policies may have a sound economic basis. In addition, countries consider that foreign ownership has to be controlled on non-economic grounds – for instance, to keep cultural or strategic activities in national hands. Consequently, the role of FDI in countries’ processes and efforts to meet development objectives can differ greatly across countries, depending on the nature of the economy and the government.

Managing FDI policy effectively in the context of a broader competitiveness strategy is a demanding task. A passive, *laissez-faire*, approach may not be sufficient because of failures in markets and deficiencies in existing institutions. Such an approach may not attract sufficient FDI, extract all the potential benefits FDI offers, or induce TNCs to operate by best-practice standards. However, a *laissez-faire* FDI strategy may yield benefits in host countries that have under-performed in terms of competitiveness and investment attraction because of past policies. Such a strategy sends a strong signal to the investment community that the economy is open for business. FDI will be attracted into areas of existing comparative advantage. However, there are two problems. First, if attractive locational assets are limited, or their use is held back by poor infrastructure or non-economic risk, there will be little FDI response. Second, even if FDI enters, its benefits are likely to be static and will run out when existing advantages are used up. To ensure that FDI is sustained over time and enters new activities requires policy intervention, both to target investors and to raise the quality of local factors.

What all this suggests is that there is no ideal universal strategy on FDI. Any strategy has to suit the particular conditions of a country at any particular time, and evolve as the country’s needs and its competitive position in the world change. Increasingly, it also has to take into account the fact that international investment agreements set parameters for domestic policy making. Governments of developing countries need to ensure, therefore, that such agreements do leave them the policy space they require to pursue their development strategies. Formulating and implementing an effective strategy requires above all a development vision, coherence and coordination. It also requires the ability to decide on trade-offs between different objectives of development. In a typical structure of policy making, this requires the FDI strategy-making body to be placed near the head of government so that a strategic view of national needs and priorities can be formed and enforced.

### 4.3. Incentives to investment

An appreciation of the benefits that FDI can bring, together with the widespread adoption of development strategies based on increased integration in the world economy, have resulted in most countries actively seeking FDI, often with the use of incentives. As competition for FDI intensifies, potential host governments find it increasingly difficult to offer less favorable conditions for foreign investment than those offered by competing nations. Investment incentives can be classified into:
- *financial incentives*, involving the provision of funds directly to the foreign investor by the host government, for example, in the form of investment grants and subsidized credits;

- *fiscal incentives*, designed to reduce the overall tax burden for a foreign investor. To this category belong such items as tax holidays, and exemptions from import duties on raw materials, intermediate inputs and capital goods;

- *indirect incentives*, designed to enhance the profitability of a FDI in various indirect ways. For example, the government may provide land and designated infrastructure at less-than-commercial prices. Or it may grant the foreign firm a privileged market position, in the form of preferential access to government contracts, a monopoly position, a closing of the market for further entry, protection from import competition or special regulatory treatment.

A number of governments have voiced concern with the proliferation of investment incentives perceived to distort investment patterns in favor of countries with "deep pockets". At the same time, the bilateral and regional investment agreements discussed below in Part IV reveal reluctance on the part of governments to extend policy disciplines to investment incentives. The closest governments have come to a collective effort to limit the use of investment incentives is the inclusion of certain provisions in the WTO Agreement on Subsidies and Countervailing Measures.

However, the situation in the real world where competition for FDI actually takes place is very different - so different, in fact, that the case for using investment incentives must be heavily qualified, if not totally rejected. The arguments can be broadly grouped into four categories:

- *distributional considerations*. Investment incentives transfer part of the value of FDI-related spillovers from the host countries to TNCs. The more intense the competition among potential hosts, the greater is the proportion of potential gains which are transferred to the TNCs. If the total stock of FDI available for investment in a region is largely insensitive to the amount of incentives being offered, host countries may find themselves providing incentives that simply neutralize other countries' incentives, without actually increasing the amount of FDI they obtain. Such incentives are nothing more than a transfer of income from these countries to the investing firms.

- *knowledge considerations*. Arguments in favor of incentives rely heavily on the assumption that governments have detailed knowledge of the value/size of the positive externalities associated with each FDI project. In practice, it would be an almost impossible task to calculate these effects with any accuracy, even with the aid of well-trained specialists. In reality, getting drawn into competitive bidding for an FDI project is like sending government officials to an auction to bid on an item whose actual value to the country is largely a mystery. As the winning host country generally is the one with the most (over-) optimistic assessment of the project's value to the country, incentive competition can give rise to over-bidding, the so-called "winner's curse". If a country offers $185 million in incentives to obtain an FDI project that brings $135 million in total benefits, the country as a whole is $50 million worse off with the FDI.

- *political economy considerations*. Lack of knowledge is not the only reason a government might offer an amount of incentives that exceeds the benefits of the FDI. The benefits from a particular FDI project are likely to accrue to certain
groups within the economy - for example, to a particular region or to workers fortunate enough to get jobs with the affiliate - while the costs of the investment incentives are likely to be spread more equally across the society. This different incidence of benefits and costs among groups in the host country opens the door for politically influential special interest groups to lobby the government to provide investment incentives which primarily benefit them, but which are largely paid for by other groups. The previously mentioned knowledge limitations simply open this door even wider.

- **introducing new distortions.** The discussion has assumed that the cost to a host country of providing a million dollars worth of incentives is just a million dollars. This is overly optimistic. Financial incentives must be financed, and taxes create their own inefficiencies. Fiscal incentives are no better, and non-pecuniary (indirect) incentives can be even worse. For example, granting a monopoly position to a foreign firm allows the host government to escape direct budgetary outlays by shifting the cost onto consumers in the form of higher than necessary prices. Developing countries, in particular, may for budgetary or balance-of-payment reasons feel compelled to utilize highly distorting incentives, such as monopoly rights and guarantees against import competition to foreign investment projects. In contrast, developed countries with "deeper pockets" may offer straightforward financial grants with less distorting effects. This asymmetry puts developing countries at an extra disadvantage when competing for FDI, beyond a simple lack of deep pockets.

Once the realities of using investment incentives to compete for FDI are taken into account, one may be tempted to conclude that the world economy - and the vast majority of individual countries - would be better off with a multilateral agreement that included limitations on the use of investment incentives. Such incentives are no different from any other kind of subsidy program and, as with most other kinds of subsidies, developed countries (and in this case the largest developing countries) can out-spend the vast majority of other countries. Under very stringent conditions, investment incentives can correct for market imperfections. But the reality is that the necessary knowledge is missing, the programs are very vulnerable to political capture by special interest groups, and there is considerable scope not only for introducing new distortions, but also for redistributing income in a regressive way. The latter effect is a particular concern since developing countries as a group are net recipients of FDI.

A country’s attractiveness to FDI is quite closely linked to the degree of transparency of their policies. The more transparent are the policies, the more attractive the country concerned is to foreign investors. Simulations have shown that not only the relationship between transparency and FDI inflows is positive but this relationship is in fact quite strong. An improvement in a country’s ranking by only a few points will significantly improve its attractiveness to foreign investors and should lead to a correspondingly large marginal inflows of FDI. Policy makers should pay a great deal of attention to transparency as a feature of their policies. They should concentrate on this aspect of policy – making perhaps even more than attempting to “fine-tune” other policies to attract foreign investment – in particular those concerning financial incentives.

In a study conducted by the Foreign Investment Advisory Service, under the coordination of Prof. Charles-Albert Michale[56] some results could provide a good picture of what makes a country attractive from the viewpoint of global investors. To put a country
on their short list, global investors consider two separate sets of variables and both sets are prerequisites. The first group is made of what may be called the institutional background of an attractive investment climate. The second group is more directly related to doing business with a country’s supply of economic and human resources. If the latter fits what the TNC is looking for according to its strategy, and as long as the institutional background is fine, the country might be put on the short list. This step is a necessary condition for attracting FDI. However, in most cases, it is not a sufficient one. According to the inquiry’s findings, there are five main groups of economic and social factors that are necessary to make a country attractive:
- a big and growing market,
- an efficient communication system,
- qualified labor,
- privatization programs (opportunities),
- fiscal incentives (tax holidays or subsidies).

Nevertheless, when making a FDI decision, involving any country around the world, there are several additional criteria a TNC may follow, in order to improve the quality and the results of its investment. The priority given to each item will depend on each investor’s evaluation:
- local market characteristics
- market access
- currency risk
- capital repatriation
- protection of intellectual property rights
- trade policies
- government regulation
- tax rates and incentives
- political stability
- macroeconomic policy framework
- infrastructure/support services

Last, but not least, a few words about privatization, a process that has been taking place in Brazil for the last decade. Foreign direct investment can play an important role in making a privatization program successful. The inclusion of foreign investors increases the pool of potential bidders with strong financial resources and technical expertise, raising the chances for these enterprises to be transformed into efficient and profitable entities. But foreign investors will not just automatically participate in any privatization. In order to design an attractive privatization program, developing country governments have to take into consideration investor concerns. Political commitment, business orientation, and transparency are fundamental principles of any successful privatization program. Only if every element of the process - from the design of the general political, legal, and institutional framework down to every single step in the actual sales procedure - is based on these principles, can a government expect strong participation by foreign investors.

4.4. Investment promotion

Investment promotion is defined to include only certain marketing activities through which governments try to attract foreign direct investors. Promotion excludes the granting of incentives to foreign investors, the screening of foreign investment, and negotiation with
foreign investors, even though many of the organizations responsible for conducting investment promotion activities may also conduct these other activities.

Investment promotion includes the following types of activity:
- advertising,
- direct mailing,
- investment seminars,
- investment missions,
- participation in trade shows and exhibitions,
- distribution of literature,
- one-to-one direct marketing efforts,
- preparation of itineraries for visits of prospective investors,
- matching prospective investors with local partners,
- acquiring permits and approvals from various government departments,
- preparing project proposals,
- conducting feasibility studies,
- providing services to the investor after projects have become operational.

Promotional techniques consist of providing information to potential investors, creating an attractive image of the country as a place to invest, and providing services to prospective investors. Promotion is only one of several tools available to countries eager to attract foreign investment. Governments offer tax incentives and grants; provide industrial estates, export processing zones, and other infrastructure; and attempt to simplify the bureaucratic procedures facing potential investors, for example. They negotiate bilateral tax, trade, and investment treaties with countries from wherever investments might come. They attempt to create a favorable environment by guaranteeing repatriation of profits, assuring access to imported components, and promising not to expropriate property without compensation. Further, governments recognize the importance of political stability, realistic exchange rates, and rapid growth in attracting foreign investment. Although attracting foreign investment requires efforts in many areas, promotion techniques provide an important mechanism for communicating all these efforts to potential investors.

Promotion efforts are the result of competition by governments in the effort to attract foreign direct investment. This competition is not entirely new; what is new is its aggressiveness and intensity. Competition for foreign direct investment has also increased because of the entry of new players. Developing countries that traditionally, because of their large domestic markets or significant reserves of natural resources, did not think it necessary to compete for foreign investment have begun to compete seriously for export-oriented investment. This phenomenon appears to be the result of, among other things, changes in the international economic environment that have characterized the period of the late 1970s and the 1980s. During this period, raw material prices seemed more unstable than usual. At the same time, import-substituting policies seemed to be running out of steam. As a result, an increasing number of developing countries eschewed resource-driven and import-oriented growth strategies in favor of growth strategies that emphasized the export of manufactured goods. Further, during the same period, industrial countries became even more active as they began to court not only firms from other industrial countries but also firms from developing countries that were beginning to spawn their own multinational enterprises.

The rationale for public programs to promote foreign direct investment in developing countries is built on the need to overcome the effects of the market
imperfections on investment decisions. For example, it is thought that information about investment opportunities in unfamiliar environments is either unavailable to outside investors, or may be too difficult to find under normal circumstances. It is also sometimes thought that the factors constraining FDI are particularly acute for smaller firms in industrial countries because they have less capacity than larger firms to search for information. Smaller firms also may have less experience with international business and thus may be more prone to overestimate risk in foreign environments.

The need for investment promotion is bolstered by what is known about investment decision processes. Studies of foreign investment decisions show that even the largest firms do not systematically search the environment for investment opportunities. Rather, such a search is often a response to problems from the external environment. While firms follow strategies that can include foreign involvement, these strategies are usually shaped within a narrow range of options. As a result, it has been documented that some foreign investors tend to exhibit follow-the-leader behavior. That is, they respond to the actions of competitors rather than acting as independent decision-makers searching the whole environment for the best investment opportunities.

In these circumstances, promotional activities may have an impact on a firm's decisions. There will be opportunities unidentified and countries uninvestigated because there has been no significant reason to do so. Promotional activities can provide that reason by introducing new information into the decision processes of firms, forcing them to enlarge the set of options considered.

With trade liberalization becoming increasingly popular and new attitudes toward foreign investment taking hold across much of the world, the approaches governments use to attract, screen, service, and monitor foreign investment are undergoing change - and not always for the better.

Thus experience is necessary and it shows that investment promotion requires functional expertise in certain key areas. National circumstances can guide the degree of emphasis these functions should receive relative to one another and how that emphasis might change over time. To one degree or another, however, each of the key functions is present when investment promotion is conducted according to international best-practice standards. The key functions of investment promotion include the following:

- **image-building**: it is the function of creating the perception of a country as an attractive site for international investment. Activities commonly associated with image building include focused advertising, public relations events, the generation of favorable news stories by cultivating journalists, etc.

- **information**: a key function of any investment promotion agency is to gather and distribute the information that prospective investors need to evaluate the attractiveness of a country as an investment site. Potential investors will require accurate answers to questions across a wide range of topics, including current macro-economic data, domestic laws and regulations pertaining to investing and conducting business, the local costs of land, labor, energy and other factors of production, and information pertaining to specific business sectors.

- **investor facilitation**: it refers to the range of services provided in a host country which can assist an investor in analyzing investment decisions, establishing a business, and maintaining it in good standing.

- **policy feedback**: investment promotion generates market-based information on a country's strengths and weaknesses relative to other investment locations.
Governments can use this information to adjust, maintain or strengthen competitiveness.

- **investment generation**: it entails targeting specific companies and persuading them to choose your country as an investment site. A promotion agency that engages in investment generation may need to employ senior and more experienced staff members. In most cases, the necessary level of expertise already exist in the industrial community and in other parts of government. A collaboration with all parties could be used by the investment promotion agency to draw on their inputs. In other cases, part-time consultants rather than full-time staff can most effectively provide technical expertise.

A good strategy provides a frame of reference and a program of work for the investment promotion agency. In developing an investment promotion strategy, it is necessary to determine the short- and long-term objectives of investment promotion and to find the appropriate balance between investment promotion activities, taking into account important factors such as the investment environment, the comparative advantages of the country, and global developments and recognizing that these factors change over time. The development of a strategy also entails understanding what to promote, where to promote, and how to tailor and time the message to achieve maximum impact.

Effective promotion should go beyond simply “marketing a country”, into coordinating the supply of a country’s immobile assets with the specific needs of targeted investors. This addresses potential failures in markets and institutions – for skills, technical services or infrastructure – in relation to the specific needs of new activities targeted via FDI. A developing country may not be able to meet, without special effort, such needs, particularly in activities with advanced skill and technology requirements. The attraction of FDI into such industries can be greatly helped if a host government discovers the needs of TNCs and takes steps to cater them. The information and skill needs of such coordination and targeting exceed those of investment promotion *per se*, requiring investment promotion agencies to have detailed knowledge of the technologies involved (skill, logistical, infrastructural, supply and institutional needs), as well as of the strategies of the relevant TNCs.

This way, the first steps could be the following:
- a survey of existing and potential investors to get their views on the FDI environment in a given country and the comparative advantages of that country;
- development of a recommended strategic mix of investment promotion activities, taking into account the quality of the business environment, the country's overall development objectives – if articulated, factor endowments, and investors' perceptions; and
- identification of the key sectors that may be candidates for targeted promotion.

### 4.5. The creation and the role of the agencies

#### 4.5.1. Some basic issues

A host governments' side of relations with foreign direct investors consists of a number of steps:

- attracting foreign direct investment through a marketing mix of product, promotional, and pricing strategies;
- screening foreign investment proposals to identify those that are desirable and deserve support;
- monitoring foreign investment to ensure that the investment conforms to expectations;
- intervening in foreign direct investment if the operations can be made more favorable.

These actions are very sensitive in terms of which attributions should be taken by FIRCE and which ones should be taken by a Brazilian foreign investment promotion agency, so that there is cooperation rather than conflict between them. In terms of the institutional arrangements to attract FDI, it is a consensus that the task is clearer if responsibility for this work is placed in the hands of one agency. New agencies have been established or existing agencies re-constituted in recent years by a number of Latin American countries. In an international environment of increasing competition, it is seen as important to assign dedicated and clear institutional responsibilities to promote and attract FDI. Primary responsibilities of such agencies are to disseminate information worldwide to improve national image and make investors more aware of investment opportunities. The importance of this task should be not underestimated – historically many investors have had a poor image of Latin America as an investment location and may not distinguish well between countries. Agencies need to continuously work to change this image. In addition, agencies contribute to regional and provincial development, undertake extensive marketing and selling activity, act as “private sector facilitators”, and participate in policy development and international investment treaty discussions.

At the Workshop on FDI Policy and Promotion in Latin America, held in Lima, Peru, on December 1998, there was a lot of discussion about the best practice in promoting FDI in Latin America, in order to create an attractive environment for investors. In the discussion about the creation of agencies, four important features emerged:
- the joint involvement of the private sector where possible (e.g. on promoting missions, in meeting new investors and on agency boards where such exist, etc.) was seen as beneficial,
- the creation of the one-stop-shop agency insofar as possible,
- the need to have focused strategies in investment promotion aimed at relevant target sectors and companies with good prospects for high-value added products,
- ensuring that agency staff have the necessary business and sectoral skills to be competent discussion partners with potential investors.

Indeed, one of the most widely recommended and widely instituted changes has been the move to some kind of “one-stop shop” approach to the management of a government's relations with foreign investors. The one-stop shop takes various forms in practice. The expectation that typically lies behind such a title, however, is that a single organization in a country is to have responsibility for conducting or coordinating various matters related to the entry or supervision of foreign investment. Thus, a would-be foreign investor would have to deal only with this one organization to obtain all the permits needed to invest in the country.

One organization with responsibility for all investment matters could achieve several goals. In its evaluation of proposed investments, such an organization could weigh rationally all the advantages and disadvantages of a proposed investment because of its broad perspective and its ability to assemble expertise on a variety of matters in one place. In addition, it could capture the learning benefits to be derived from frequent negotiations
with foreign investors. Finally, and usually most important, such an organization could reach decisions relatively quickly and predictably because only one entity would be involved. Speed and predictability of decisions are thought to be important elements in a program designed to encourage foreign investment. The advantages of one-stop organizations are also believed to extend to other government activities during an investment’s life, such as promoting the investment, providing services to investors, and monitoring investment projects.

4.5.2. The “one-stop-shop” approach

The first step for most countries that have made the decision to open their borders to foreign investment is to set up an agency to attract potential investors. And while significant intellectual resources have been dedicated to understanding management and decision making systems in multinational enterprises, there is only diffuse knowledge of the activities promotion agencies perform and how they should be organized.

A 1997 study, conducted by the Foreign Investment Advisory Service for the International Finance Corporation, surveyed 14 agencies in Latin America and the Caribbean, covering central themes as promotion activities, investor services, and structure and funding. Some interesting results are shown below, on figure 4.5.1.1.

**Figure 4.5.2.1. Some results of the FIAS Survey on investment agencies**
Additionally, FIAS experience around the world has shown three basic types of organizations: a government agency dependent on a Ministry, an independent government agency, or a private agency. In Latin America, the distribution of agencies is shown on figure 4.5.2., in the previous page.

Yet even the proponents of one-stop organizations recognize that they have certain disadvantages. For instance, they usually lack the industry expertise that an industry-specific agency could provide, as well as the functional expertise of a line ministry. The national oil-company, for example, is likely to know the oil industry better than any one-stop investment authority. Similarly, a country's department of revenue is the agency most likely to be conversant with the intricacies of corporate taxation. Nevertheless, for the management of most categories of foreign investment in a country, the advantages of these one-stop organizations seem to outweigh any disadvantages.

One-stop shops seldom perform as predicted, however, despite the labels governments attach to these creations. Many of these organizations, although created with the goals mentioned above in mind, have been able neither to improve the quality of the foreign investment that enters a country, nor, in many cases, to speed up the decision and approval process to facilitate the inflow of a greater quantity of investment. This study concludes that the ineffectiveness of many one-stop shops results from the failure of government to exercise sufficient will to change decision processes. Structural changes that are made often apply to administrative processes alone; change in administrative processes without corresponding change in decision processes leads to failure on the part of government to achieve the desired results.

4.5.3. The “screening” function

Of the various activities of one-stop shops, or other organizations designed to deal with foreign investors, the screening function generally receives the most attention. Screening may be used to decide which foreign investments should be allowed to enter the country; alternatively, for countries that offer incentives, screening may be used to decide which investment projects qualify for these incentives. A government may, of course, elect
not to carry out screening. Instead, it can allow all (or no) foreign investors to enter, or it can grant incentives to all (or no) investors. The rationale for screening is to protect the country from investors who might pursue projects that would be injurious to the economy or from wasting incentives on projects that are not the most beneficial or the most needed.

To the governments of most developing countries, the case for screening seems so compelling that few governments are completely open to foreign investment: most have some mechanism to admit foreign investors selectively or to exercise some choice in allocating incentives. Countries vary widely, however, in the stringency of their entry regulations. Most have general laws or regulations that prohibit foreign investment in certain industries, such as the distributive trade, local transportation, and utilities. Others prohibit substantial foreign ownership of firms or industries that are critical to the nation's defense. Some countries have only general rules in place; others have an active policy of screening each investment (although the applicable criteria governing the decisions that are made may not be at all transparent).

The project-by-project approach to screening seems, on the surface, to be more appealing to a country, given that reliance on general laws might allow the entry of damaging investments. The strongest case for the project-by-project approach is made by countries with tariff and other protection against competition. But even though their governments have relied on screening to reject harmful projects, the skimpy data that exist (largely from one study and considerable casual evidence) suggest that such screening has not been very effective. Indeed, in some cases, it seems that harmful projects have about the same chance of passing through the screen as beneficial ones.

Laying aside the question of benefits or results, the screening process does, nevertheless, have real costs. As a practical matter, case-by-case screening often is not well performed and the process itself may discourage would-be investors. Smaller firms are particularly likely to be dissuaded by the investment in money and management time required to proceeding through the uncertain screening process. Thus, screening may turn away a disproportionate number of investments that would be beneficial to a country's economy and consume the time of bureaucrats who might be more efficiently employed elsewhere.

Given the costs of screening, and its apparently poor results, the process has come under attack in reform programs. Those who support such attacks argue that screening not only fails to work well but is less necessary with liberal trade policies. There is evidence to show that more open trade regimes lead to fewer harmful foreign investment. Improving the mechanisms by which governments screen incoming investment thus may be less effective than reforming trade policy. Because trade reform may proceed slowly, or not at all in some countries, improving the screening process may be an essential "second-best" policy. In some cases, we will argue that the use of rules of thumb for screening can accomplish a great deal, either in the transition period to liberalization or even over the longer term. We also suggest ways to improve the operations of screening organizations.

Of course, screening is not the only function of one-stop and other government organizations concerned with foreign investment. With their new attitudes toward such investment, governments have sought to offer a collection of services to investors, under the assumption that a greater service orientation would ease the entry of foreign firms and encourage more investment. Usually, governments link the decisions they make about appropriate service organizations with their decisions about how to structure the screening
activity. Policies to affect one activity generally have affected the other, largely because little attention has been paid to the separate requirements of the service function.

4.5.4. Structuring an investment promotion agency

Several governments have, on occasion, been severely criticized for not adequately monitoring the activities of foreign investors in their countries. Criticism runs the gamut from that of academics, who bemoan the lack of useful data for research, to political opponents, who complain that governments grant incentives to investors who promise to deliver certain benefits but never check to see that the firms actually deliver what they promise. Again, there is a dearth of empirical work on what kinds of monitoring governments actually perform, and why. This, of course, constitutes a subject of reflection by FIRCE.

Most of the times, the central issue that host governments face in carrying out their investment promotion efforts relates to the nature of the institutional framework that will execute these efforts. In principle, there are two ways to structure an investment promotion agency:

- **as a government organization**: a government could carry out investment promotion itself (directly as a part of its administrative structure), but this approach has the disadvantage that the government organization may be unable to acquire the skills required to manage the activity properly. The required skills may reside in the private sector and attracting them to the public sector may prove difficult, especially with the salary constraints typical of the public sector. Another option is the creation of a "quasi-governmental" organization. This involves an independent agency, funded (in total or to a large degree) by the government but separated from the government ministries and public financial institutions. This separation would create the image of an independent organization that is dedicated to serving the interests of investors.

- **As a private sector organization**: an alternative approach is for the government to delegate the management of investment promotion activities to the private sector. This approach often has the disadvantage that the private sector may not execute effectively those related activities, which are traditionally government responsibilities.

Regardless of the approach that is chosen, there will be management issues with respect to how the inherent disadvantages of either approach are to be overcome. In an attempt to overcome these disadvantages, governments may search for the organizational approaches that combine most effectively, the skills and resources of both the public and private sector. The effort in the development/strengthening of an institution capable of carrying out an investment promotion strategy should then focus on two aspects: the institutional framework of the agency, and its internal structure and capacity.

It is possible to summarize the critical issues for investment promotion and agencies in today’s competitive world environment:

- clear distinction needs to be made in promotion between different categories of FDI: location-specific investment which is restricted to a particular location (e.g. to get access to natural resources or the acquisition of a specific company) and mobile investment (in establishing plants or expansion projects) which can locate in any one of numerous countries.
- Alongside unprecedented growth in the volume of FDI there should also be greater recognition of the changing pattern of FDI driven by globalization and the impact of technology, e.g. more and smaller companies were investing, new sectors and, in particular, technology and service business are fertile sources of FDI.

- The essence of successful promotion is in establishing meaningful relationships with identified target sectors and companies and providing strategic solutions to such companies. All promotion techniques should be measured against that objective.

- The most successful investment promotion agencies act like top class commercial service businesses. Their approach is highly professional and efficient. They act as development agencies where they seek not just to undertake promotion but to improve the wider environment for investors by liaising and instigating change with relevant authorities and are innovative in seeking investment in new emerging sectors. They have the mandate and resources to undertake their work and are central to national industry policy.

- There is a clear “best practice” agency model which should be recognized. Key elements of this “best practice” model include having a clear service management system which spells out the service they offer, target segment, and delivery method; uses customized marketing to target clients; pursues FDI in all elements of the value chain; roots FDI through linkage with local suppliers; achieves a high volume of repeat investment; and is focused also on opportunities in new sectors such as e-commerce, software, biotechnology, multimedia, etc.

It may be difficult to staff a promotion agency with appropriate people. The agency must successfully interact with government, if it is to be of service to investors when they are implementing their projects and if it is to influence policy and the bureaucracy. On the other hand, it must have people who are oriented toward sales. These kinds of marketing people are rare in the public sector and they earn high salaries in the private sector. Measuring the performance of an agency, or its employees, is difficult for three reasons:

- it is not easy to attribute investment to a particular cause,
- the results from investment promotion may come long after the activities that originally led to the investment, and
- many of the barriers to foreign investment lie outside the control of the agency.

All the considerations above are very important for the successful implementation of the Brazilian investment promotion agency, which is expected to have a fundamental economic role for the next decade or so.

4.6. Some comments about the Brazilian experience on FDI promotion

Brazil has become one of the leading recipients of foreign direct investment (FDI) in the world. Major economic reforms and large-scale privatizations have enhanced Brazil's attractiveness as the largest Latin American market and as a key player in Mercosur. This trend should pick up speed in the coming years with further liberalization, the restructuring of the Brazilian economy and the pursuance of economic integration. There is every reason to commend the policies adopted by the Government of Brazil to eliminate discriminatory treatment towards foreign investors and their investments, protect their tangible and intangible assets and provide for the resolution of investment disputes.
Less than two years ago, a study made by OECD[60] highlighted, however, some lingering areas of concern, notably with respect to access to the banking system, government discretionary action and existing market distortions. OECD claimed for the adherence to its liberalization principles, stating that it should consolidate the reform process in Brazil while providing a favorable framework for the expansion of FDI relations between Brazil and OECD countries.

In spite of OECD’s comments, the fact is that Brazil has made a lot of progress in last decade. The experience of promoting foreign direct investment in Brazil has not been structured up to very recently. Historically, the most consistent initiative usually came from the Ministry of Foreign Relations, through its “Investment and Technology Transfer Promotion System” (SIPRI)[61]. The main goals of this system have been to attract foreign direct investment to Brazil and to establish partnerships between non-Brazilian companies and Brazilian companies which ensue the transfer of new technologies to Brazil. Abroad, the SIPRI operates through 52 Brazilian Trade Bureaus in Brazilian Embassies and Consulates-General. Within Brazil, a group of institutions known as Focal Points works in conjunction with the Ministry of Foreign Relations in the dissemination of investment opportunities (Investment Offers, generated abroad, and Investment Demands, generated in Brazil).

The first step to use SIPRI has consisted in the registration of the interested company or entity in the appropriate register: Brazilian Companies, Brazilian Class Entities and Other Institutions or Non-Brazilian Companies. Once registered, the Brazilian firm interested in receiving foreign direct investment will fill out an “Investment Demand” form. The Non-Brazilian company interested in investing in Brazil should fill out an “Investment Offer” form. Registered companies may, alternatively, find an investment partner by conducting a search for investment offers or investment demands, according to the products, activities, type of companies and type of partnership (joint-venture, subcontracting, franchising, etc.) they prefer.

SIPRI has been able to leverage several important business, but it lacks focus. It must be said that, in an effort to leverage resources, many countries, including Brazil in some occasions, have been tempted to charge their embassies abroad with carrying out investment promotion, but the fact is that officials in embassies are trained in skills that are different from those required for promotion. That is not to say that there is no role for embassies in investment promotion. Indeed, they should be encouraged to forward information about any requests they receive to the investment promotion office, for follow up. A major achievement of SIPRI is that it is mentioned in the web site of the Investment Promotion Agencies Network (IPANet), a network created to facilitate FDI in emerging markets[62].

Several State governments also make their own efforts to have access and keep in touch with international direct investors. Also through the IPANet, the State of Minas Gerais provides access to its Industrial Development Institute (INDI), as an information and communication channel for investors. There have been some initiatives taken by the private sector, through some institutions, some of them resulting from partnerships with foreign governments or corporations.

The foreign investor may also find very useful information by looking into the Foreign Capital Department (FIRCE) page in the Internet[63], in the site of the Central Bank of Brazil, where it is possible to have access to updated legislation on FDI. Some sources of information come from law firms interested in providing advisory services to foreign
investors. One of these sources is a guide called “Company formation in Brazil”[^4], which provides very useful and updated information on legal aspects of foreign capital in Brazil.

A comprehensive set of information can also be found in the “Legal guide for the foreign investor in Brazil”[^5], which contains topics such as:

- institutions that finance economic development in Brazil
- foreign capital legislation (register, investments, reinvestments, profit remittance, restrictions)
- types of business organizations
- financial system rules
- monetary exchange regime
- anti-trust legislation
- consumer rights
- labor legislation
- foreign workers
- intellectual property
- privatization law and procedures
- real estate
- environmental legislation
- international treaties

On February 2000, UNCTAD launched investment and enterprise development programs with five countries in Latin America, the region which since 1999 has become the largest recipient of foreign direct investment (FDI) in the developing world[^6]. The countries are Bolivia, Brazil, El Salvador, Guatemala and Panama. The project in Brazil is aimed at improving the effectiveness of its investment promotion program by helping the country to attract “better” FDI - investment in key industries, and investment that is export-oriented. Although Brazil leads the region as of 1999, with its US$31 billion in FDI -- 40% of the regional total -- most of that investment was triggered by privatization or by attempts to meet the needs of the domestic market. UNCTAD’s assistance is designed in part to enhance the positive impact of FDI through linkages to export-oriented small and medium-sized enterprises (SMEs). A capacity-building program will be set up to make government focal points for investment promotion more effective, and use of the Internet as a marketing tool to attract new investments will be developed. The project is being funded by the Swiss Government.

The nature of the capital flows that went into Brazil in last years was primarily driven to privatization purposes, what brings about again the question of some worries concerning foreign investment in non-tradables sectors and the future impact over the balance of payments. What is most important is that, as privatization opportunities decrease, there is a need to keep the incoming volumes of foreign investment high. Since the moment is adequate, in terms of foreign interest on Brazil, the Government made a step to consolidate the trend of high flows: the Brazilian Investment Promotion Agency is being created, as an entity with the specific goal of attracting permanent funds for the productive sector. It is a result of an association among the Federal Government, some state-owned firms and some private class associations. The first presentation of the agency project was given by the Brazilian Minister of Planning at the Inter-American Development Bank Annual Meeting, which took place in New Orleans, on March 2000.

One of the Government’s strategy consists in the creation of a site in the Internet, providing all information that can be useful for the foreign investor, as such as tributes, tax
incentives, legislation on environmental issues and, of course inform where the opportunities are. FIRCE is expected to have a vital role in providing the site with aggregated updated information about FDI, by country and industry sector. This makes it very important to FIRCE to speed up its efforts in the preparation of the Census of Foreign Capital 2000. There must be a very deep interaction between FIRCE and the new agency.

The official announcement of the Brazilian Investment Promotion Agency is gonna take place in April 2000. It still needs to perform some legal process of approval and the idea is to have it running as an experiment, up to December 2000, when its effective contribution will be evaluated. It means a remarkable partnership between the Government and the private sector. Its staff will include officials from the Ministry of Finance, Ministry of Foreign Relations, Ministry of Planning, Central Bank and the Brazilian National Bank for Economic and Social Development (BNDES). From the private sector side, there is the National Industry Confederation (CNI), the National Commerce Confederation (CNC), the National Transports Confederation (CNT), the National Confederation of Financial Institutions (CNIF), the Brazilian Support Service to Small and mid-Size Enterprises (SEBRAE), the Sao Paulo Stock Exchange (BOVESPA), the Futures and Trade Exchange (BM&F), the National Association of Open-Market Institutions (ANDIMA) and bilateral commerce chambers.

The agency must be attempt to the basic steps of investor services:
- pre-investment decision: includes giving potential investors information about the country and about procedures required of investors. Some investment promotion agencies provide only very general information – often only macroeconomic data. In contrast, other agencies provide detailed data, sometimes customized to the needs of particular kinds of investors.
- implementation: help investors through the process of building up their projects. In some countries, this kind of service is provided perfectly well by private sector groups. Often, a few law or accounting firms specialize in assisting the investor, as it has happened in Brazil. When promotion agencies get deeply engaged with investors in this stage, it helps the agencies to understand the problems investors face.
- post-investment services: these have been provided based on the belief that happy investors expand their operations and help attract other investors to a country. They comprise efforts to assist companies to overcome problems they encounter while operating.

There is a lot to accomplished by FIRCE and the promotion agency together, and FIRCE can be a major provider of data and information for the first step. The new strategy of the Brazilian Government does require an information unit specialized in FDI data-collection, compilation and dissemination.
Conclusion

Having addressed so many issues related to FDI, it may seem almost impossible to draw some conclusions and come up with some suggestions for further action and research. There are many more questions than answers concerning the relations among FDI and main economic variables that influence the policies towards sustainable economic development. Nevertheless, it is feasible to group the main observations in terms of the point of view of the foreign investor and the Brazilian government, and understand the role that the Foreign Capital Department (FIRCE) and the Brazilian investment promotion agency could play. There is a lot to be done in terms of the data collection, dissemination and use of the best and most precise and timely information about FDI in the country and the effective use of this information for nationwide industrial policies, including promotion actions.

It is clear that the dramatic growth in FDI flows in the 1990s and over time since the 1970s has brought about a greater degree of integration of the world economy than could have been achieved by trade alone. The record levels of investment flows recently owe much to several large cross-border mergers and hence could well abate somewhat when the current international merger wave subsides. The integration of the global economy through TNCs would nevertheless continue through the activities of smaller investors and their myriad transactions, whose importance is often underestimated.

Global integration will continue to drive FDI flows, wherever the economic environment is open to it. Globalization will increasingly blur the distinction between foreign and domestically owned enterprises, and between developed and developing countries. Countries that are open to foreign investment stand to share in the rising global prosperity that globalization brings.

Nevertheless, to create an enabling environment for FDI, a large unfinished agenda of policy reform remains. Some of the countries that have made progress in reducing restrictions, including some already receiving large amounts of FDI, still have some way to go toward providing a fully open environment for FDI. Many more countries have only begun to reexamine their policies toward FDI or the impact of their general economic policies on FDI flows. Yet these countries have not missed their chance to participate in global FDI flows. The rapid increase in FDI volumes in recent years has shown that this is not a zero sum game. As more countries open up to FDI, global integration will increase, leading to an increase in overall FDI flows. The challenge for the future is therefore to open more economies and sectors to foreign direct investment, thereby bringing opportunities for economic development to a larger part of the developing world.

The mobilization of additional resources to help sustain high levels of growth where they have already been attained, and to accelerate growth in other cases, will require action both in the domestic policy arena and at the international level. Important domestic policy issues include export expansion, diversification and competitiveness. Much has been written about the need for further policy reform to improve the macroeconomic and governance environment. This is important not only for attracting foreign investment but also for reducing the extent of capital flight. In addition, a lot can be done at the regional level to bolster the macroeconomic environment and improve investor perceptions of risk.

In a globalizing world economy, governments increasingly need to address the challenge of development in an open environment. FDI can play a role in meeting this challenge. Indeed, expectations are high, perhaps too high, as to what FDI can do. But it seems clear that if TNCs contribute to development – and do so significantly and visibly –
the relationship that has emerged between host country governments, particularly in Brazil, and TNCs over the past 15-20 years can develop further with potential benefits for all concerned. In this sense, information is vital in the sense that it provides means to examine the functionality and the real contribution of the FDI.

Foreign investment will be a major factor in the global economy of today and tomorrow. Recent trends, such as the emergence of regional trading arrangements like the NAFTA and the EC, point to fierce competition for the major markets in the industrialized countries. As a result, TNCs will be constantly looking to develop new markets for their products and services. Developing countries that establish appropriate policies and manage them effectively will be well poised to capitalize on these trends and capture the foreign investment that will propel them on the path to prosperity.

Foreign capital can bring an important stimulus to internal competition and productivity, through optimization of the use of resources and the adoption of updated technology. The trend of FDI towards the services sector then brings about the need for useful information on the performance of foreign firms. This information is vital to the investment promotion agency to define the economic sectors that must receive more incentives and attention, and that seems to be the case for manufacturing nowadays.

The most important determinants of FDI in Brazil in recent years include the changes made in the regulatory framework and, above all, concessions of public services and privatization of public-sector enterprises at the federal and state levels. An increasing proportion of FDI inflows since 1995 have been due to privatizations. These investments in non-tradable sectors have generated greater interest in the analysis of the impact of TNCs on Brazil’s balance of payments, since there have been problems with the current account deficit in recent years. There are still doubts as to whether FDI flows in connection with privatizations will require increasing mobilization of external resources to service productive foreign capital in the form of profit remittances. This issue is particularly serious given that resources derived from privatizations tend to diminish with time, that is, as there are fewer concessions to be granted and fewer public-sector enterprises to be sold in all the various sectors.

There are serious concerns about the impact on the long-term stability of the balance of payments, due to the recent wave of FDI into the sector of non-tradables firms in Brazil. Of course, one may not deny the contribution the newcomers may bring in terms of efficiency, but there is an urgent need for studies on that matter. In this sense, FIRCE has been spending a lot of effort in terms of following the internationally recommended standards for FDI statistics, and continuously developing a foreign investment tracking system based on those international standards. For that, several benchmarks have been used and the United States are still the major reference in terms of FDI statistical methodologies.

A new census of foreign capital is needed to evaluate the deep transformations on the Brazilian economy, due to the FDI cycle that took place from 1996 to 2000. Several sectors got a lot of investment in that period, as such as the financial system, information technology, telecommunications, biotechnology. Preparation for the new census means intensive use of the internet, both for data collection and dissemination of the results through the basic clients for that information: the Brazilian society and government (ministries and agencies) and the foreign investors. It also means publishing extensive data by geography/sector, following strict confidentiality criteria. Also important is to set procedures to update the informations on a timely basis, using a representative sample of companies – as has been done by the Bureau of Economic Analysis, at the U.S. Department
of Commerce – in order to have yearly updated information in the future. By doing so, FIRCE will fulfil its mission within the Central Bank, and it will collect a lot of support from the society, thus justifying its existence and growth, as “the only and reliable source of information on FDI”.

An extended mission could even include working with the Economic Department for providing some insights into future trends about FDI, identifying the characteristics of the industries and of projects in which FDI is most likely to have a positive impact over Brazil’s development. Additional research could investigate the relations and contributions of the FDI in different sectors (like the financial system) and the consequences in terms of GDP growth, gross capital formation, and, of course, the impact on the balance of payments.

Although FDI can yield major economic benefits for the host country, such benefits can be enhanced through appropriate policies. Governments therefore have an important role to play in creating the conditions that attract FDI and in maximizing the positive contribution that FDI can make to growth and development. Foreign direct investment will play a critical role in the rise of standards of living among nations well into the 21st century. A crucial aspect will be whether FDI’s contribution to economic development will respond in a balanced and sustainable way to the aspirations and expectations of host and home countries alike.

There are two important lessons to be learned from the recent pursuit of market-oriented reforms by the Brazilian government. The first applies to countries that do not have Brazil's market size, natural resources, and other advantages. Simply put, these countries must put in place the appropriate macroeconomic and regulatory policies if they intend to attract foreign investment, because most of them do not offer compensating benefits the way Brazil does. Investors strike a balance between a country's perceived benefits versus costs, because they realize that no country, particularly a developing country, can offer unlimited advantages with minimal costs. The trick, then, for countries interested in attracting foreign investment is to maximize the advantages that they offer through the policy tools at their disposal. After all, countries cannot select or change their location or the natural resources within their borders, but they can change their policies.

The second lesson is that countries that do put in place an effective mix of policies and incentives will attract foreign investment. The increase in foreign investment in countries that do not offer large markets or abundant natural resources attests to this truth. The global competition for investment capital has played an important role in prompting the Brazilian government to establish a more attractive climate for private investment.

Then, what conclusions can be drawn about the actions of the Brazilian government in terms of its orientation towards FDI? Four broad categories of measures call the attention: liberalization, deregulation, facilitation and offering of incentives. There is a strong dispute among developing countries in order to keep on being considered as viable economies and get FDI, in a context where these countries face increasing capital flows among developed countries and do not want to be marginalized. Liberalization is mandatory today if a country wishes to compete with others for continuous flows of FDI and Brazil can encourage greater participation by foreign investors by improving our capital-accounts regulations, which are still somewhat restrictive. Deregulation is a part of the process and most of it has been accomplished through the privatization effort. Facilitation means less or no barriers to capital flows and criterious incentives require consistent objectives and policies.
Other questions, however, arise: What are the benefits and opportunities of trying to use FDI to encourage development and what are the lingering risks and dangers? When are the benefits and opportunities likely to outweigh the risks and dangers? How well do international markets function in supplying FDI to the development process and what have been the principal obstacles preventing those markets from functioning more effectively? What is the role of market failure and marketing distortion in allocating FDI among developed countries? Beyond getting micro and macroeconomics fundamentals right, do hosts and would-be-hosts in the developing world need a distinctive policy toward FDI? Or, after concentrating on the large array of microeconomic, macroeconomic and institutional fundamentals, can they be confident that international markets will offer them appropriate amounts of FDI? If, instead, they need a distinctive policy, how should it be fashioned?

Some issues that could be addressed by the Brazilian government, with the help of FIRCE and the investment promotion agency, in order to better cope with FDI may fall into the following four groups:

• improve information on FDI and minimize coordination failures due to the international investment process;
• investigate the statistic nature of advantages transferred by TNCs where domestic capabilities are low and do not improve over time;
• be very critic and impartial when analyzing infant industry considerations in the development of local enterprises, which can be jeopardized when inward FDI crowds out those enterprises;
• avoid practices leading to weak bargaining and regulation, what can result in an unequal distribution of benefits or abuse of market power by TNCs.

The Brazilian investment promotion agency is very welcome for several reasons. It is expected that it go beyond an examination on how well FDI policies look on paper and probe how well those policies work in practice in achieving stated national objectives. It should survey actual and potential investors on how they perceive current investment conditions and opportunities, and, based on analysis of investor perceptions and of relevant FDI trends at the regional and global levels, assess the Brazilian core competencies in attracting FDI. Besides that, it must gauge the effectiveness of policies in leveraging the competitive strengths of Brazil relatively to other countries, and compare Brazilian policies, strengths and weaknesses in relation to other countries, particularly in the region. This way, it way be able to draw out useful lessons for countries that are rethinking the way they manage their relations with foreign investors. To accomplish its attributions, it is clear the need for its cooperation with FIRCE and with agencies from other countries. Establishing cooperative efforts with the Investment Promotion Agencies Network (IPAnet) as a vehicle for exchange of information is also recommended.

Based on the researched literature, it is possible to argue that:

• different combinations of promotional techniques are useful at different phases of a promotion program;
• the type of organization responsible for promotion makes a difference in effectiveness;
• there are various useful ways to evaluate a promotion program;
• investment promotion appears to have a statistically significant influence on foreign investment flows; and, particularly important,
• investment promotion programs have proved effective in attracting only certain kinds of investors.

Thus, an optimal program to attract foreign investment should allocate resources to marketing activities up to the point at which the marginal return on more resources devoted to each activity would be just less than could be obtained from allocating the resources to other activities that also attract foreign investment. The elements of a marketing mix in a consumer or industrial marketing environment are usually complementary; similarly, in a well-designed program to attract foreign investment, promotion, incentives, and policies designed to improve the "climate" of an investment site should also complement each other. Redesign of part of one element may well affect the working of another part of the marketing program.

Finally, there are some suggestions for further research, which could be conducted by FIRCE, the investment promotion agency or any other institution dealing with the subject FDI. There is a need for conducting case studies at the company and industry level in terms of the impact on the balance of payments. Some researchers may be tempted to investigate the relations between FDI and environmental impact in Brazil and also the trends in cross-border environmental management. Others may want to benchmark TNCs with domestic competitors. Concerning economic models, there is an enormous space for forecasting models to simulate the financial impacts of the TNCs transactions over the capital account. What will be the result for Brazil as a consequence of being or not being part of worldwide-integrated production networks?

The main message is that, despite all the uncertainties, longer term growth prospects—contrasted with the 1980s and 1990s—are favorable for Brazil, as efficiency gains from past reforms are realized. Growth in total factor productivity, regionwide, is likely to continue its upward trend as Brazil, the last of the large economies in the region to embark on liberalization, overcomes current difficulties. The privatization of large state enterprises in the water, electricity, transportation, and telecommunications sectors shall begin to bear fruit into this first decade of the 2000s.

The Brazilian government must be aware of the fact that privatization, combined with the increasing market power of the Southern Cone countries through Mercosur, encouraged intense FDI inflows during the 1990s, but the nature of FDI will probably shift from acquiring existing capital stock through privatization to investment in new capacity in the services and manufacturing sectors. An intriguing question is: are global firms going to slow down making new direct investment abroad, as a consequence of the M&A? In the near future, TNCs could be willing to substitute FDI for networks of foreign local partners, where specific contracts between partners would be a substitute for equity participation. Therefore, promoting FDI and a country’s attractiveness will probably require new rules for countries in the coming years.

The conclusion is that there is no ideal development strategy with respect to the use of FDI that is common for all countries at all times. Any good strategy must be context specific, reflecting a country’s level of economic development, the resource base, the specific technological context, the competitive setting, and a government’s capabilities to implement policies. As a competitive advantage, the availability of accurate information on FDI must be a priority and deserves the necessary resources to be achieved.
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Notes

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6 Michalet, 1997
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12 WTO, 1996
13 Drabek, 1998
14 NBER, 1997
15 OECD, 1997
16 OECD, 1998f
17 Glade, 1998
18 Botchwey, 2000
20 Lipsey, 1999
21 A.T. Kearney, 2000
22 UNCTAD, 2000a
23 UNCTAD, 2000b
24 KPMG, 2000
25 FIAS, 1997
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35 Megery & Sader, 1997
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42 OECD, 1999b. For more details on the proceedings from the Conference, see the Supplementary Bibliography: OECD, 1999c to OECD, 1999t.
43 see the Supplementary Bibliography: OECD, 1999c to OECD, 1999t.
45 see a short description of BEA on “Organizations”
46 see http://www.bea.doc.gov/bea/di1.htm
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Pinheiro Neto, 1999
CESA, 1998
UNCTAD, 2000e
Appendix 1: List of organizations mentioned

A.T. Kearney. It is the fastest growing, high value global management consulting firm, with a 25% compound annual growth rate over a decade and a half. It is also the second largest high value management consulting firm, acting with global scope and scale in 60 offices in more than 30 countries.

BEA Bureau of Economic Analysis. It is an agency of the Department of Commerce of the United States. Along with the Census Bureau, it is part of the Department's Economics and Statistics Administration. Its mission is to produce and disseminate accurate, timely, relevant, and cost-effective economic accounts statistics that provide government, businesses, households, and individuals with a comprehensive, up-to-date picture of economic activity. BEA’s international economic accounts encompass the international transactions accounts (balance of payments) and the estimates of U.S. direct investment abroad and foreign direct investment in the United States. Considering the similarities between the work developed by BEA and the one performed by FIRCE in Brazil, BEA’s site in the internet is a must as a reference for benchmarking in terms of methodologies and publications related to FDI.

BNDES Brazilian National Bank for Economic and Social Development. It is the chief federal agency for long-term funding which aims at promote the country's development. It has been a key player in all phases of the Brazilian development effort since it was created in 1952. BNDES operates in every sector of the economy and its strategy focuses on industrial restructuring, infrastructure expansion and revamping, and also managing the Brazilian Privatization Program. It is a public company, fully-owned by the Federal Government, and the country’s most important source for long-term financing.

CIPE Center for International Private Enterprise. It is an affiliate of the U.S. Chamber of Commerce. CIPE works in four principal areas: a grants program that currently supports over 90 indigenous organizations in developing countries, an award winning communications strategy, training programs, and technical assistance through field offices. Since its inception in 1983, CIPE has funded more than 550 projects in 70 countries and has conducted management training programs throughout the world. CIPE receives funding from the National Endowment for Democracy and the United States Agency for International Development.

ECLAC United Nations Economic Comission for Latin America and the Caribbean. Also known as CEPAL (Comision Economica para America Latina e Caribe), it has several attributions in the UM system, as such as promoting economic and social development through regional and subregional cooperation and integration and gather, organize, interpret and disseminate information and data related to economic and social development of the region.

FIAS Foreign Investment Advisory Service. Founded in 1985, it is a joint service of IFC and the World Bank. Since then, it has helped more than 110 countries to identify the essential attributes of a sound investment environment. Its staff helps developing and transition country governments design initiatives to attract foreign direct investment. It advises on laws, policies, incentives, institutions, and strategies. Basically, it helps countries increase the amount of investment they receive—and the benefits this investment produces.

ICSID International Center for Settlement of Investment Disputes. Member of the World Bank Group. It is an institution specially designed to facilitate the settlement of investment disputes between governments and foreign investors could help to promote increased flows of international investment.

IDB Inter-American Development Bank. It is the oldest and largest regional multilateral development institution, was established in December of 1959 to help accelerate economic and social development in Latin America and the Caribbean. Its principal functions are to utilize its own capital, funds raised by it in financial markets, and other available resources, for financing the development of the borrowing member countries; to supplement private investment when private capital is not available on
reasonable terms and conditions; and to provide technical assistance for the preparation, financing, and implementation of development plans and projects. the IDB Group consists of the Inter-American Investment Corporation (IIC) and the Multilateral Investment Fund (MIF).

IFC International Finance Corporation. Member of the World Bank Group. It is the largest multilateral source of loan and equity financing for private sector projects in the developing world. IFC finances and provides advice for private sector ventures and projects in developing countries in partnership with private investors and, through its advisory work, helps governments create conditions that stimulate the flow of both domestic and foreign private savings and investment. Its particular focus is to promote economic development by encouraging the growth of productive enterprise and efficient capital markets in its member countries.

IIC Inter-American Investment Corporation. Member of the IDB Group. It promotes and supports the development of the private sector and the capital markets in its Latin American and Caribbean member countries by investing, lending, innovating, and leveraging resources as the IDB Group institution charged with fostering the development of small and medium-size enterprises to further sustainable economic development.

IIE Institute for International Economics. is a private, nonprofit, nonpartisan research institution devoted to the study of international economic policy. Its purpose is to analyze important issues in that area and to develop and communicate practical new approaches for dealing with them. Since 1981, it has provided timely, objective analysis and concrete solutions to key international economic problems.

IMF International Monetary Fund. Established in 1946, it is an international organization of 182 member countries, established to promote international monetary cooperation, exchange stability, and orderly exchange arrangements; to foster economic growth and high levels of employment; and to provide temporary financial assistance to countries under adequate safeguards to help ease balance of payments adjustment.

IPAnet Investment Promotion Agencies Network. It is not an organization in its strict sense. It consists of a site at the Internet aimed at facilitating foreign direct investment in emerging markets. It has, as main sponsors, the MIGA, the Ministry of Finance of Japan, the CEI (Central European Initiative), Finanzierungsgarantie-GmbH (Austria), the Korean Trade and Investment Promotion Agency, the Spanish Ministry of Economy and Finance, the UNIDO (United Nations Industrial Development Organization) and several others.

KPMG It is the global leader consulting firm in terms of mergers and acquisitions (M&A) advisory services. It also provides consulting, tax and legal, financial advisory and assurance services from more than 820 cities in 159 countries. KPMG has made a long-term commitment to becoming the leading global professional advisory firm of choice for its clients, resulting in a strong growth: in 1999, the firm experienced 17.3 percent growth, up from 15.6 percent the previous year.

MIGA Multilateral Investment Guarantee Agency. Member of the World Bank Group. MIGA was created in 1985 to supplement national and private agencies supporting foreign direct investment through their own investment insurance programs. The Agency was designed to encourage foreign investment by providing viable alternatives in investment insurance against non-commercial risks in developing countries thereby creating investment opportunities in those countries.

NBER National Bureau of Economic Research. Founded in 1920, it is a private, nonprofit, nonpartisan research organization dedicated to promoting a greater understanding of how the economy works. Research is conducted by more than 500 university professors around the country, the leading scholars in their fields.
OECD Organization for Economic Cooperation and Development. It groups 29 member countries in an organization that provides governments a setting in which to discuss, develop and perfect economic and social policy. They compare experiences, seek answers to common problems and work to co-ordinate domestic and international policies that increasingly in today's globalized world must form a web of even practice across nations. OECD countries produce two thirds of the world's goods and services, but it is not an exclusive club. Essentially, membership is limited only by a country's commitment to a market economy and a pluralistic democracy.

OPIC Overseas Private Investment Corporation. It is a U.S. government agency, assisting U.S. private investment overseas, providing political risk insurance and loans to business of all sizes. www.opic.gov

UNCTAD United Nations Conference on Trade and Development. Established in 1964 in Geneva, Switzerland, as a permanent intergovernmental body, UNCTAD is the principal organ of the United Nations General Assembly in the field of trade and development. Its main goals are to maximize the trade, investment and development opportunities of developing countries, and to help them face challenges arising from globalization and integrate into the world economy, on an equitable basis.

WAIPA World Association of Investment Promotion Agencies. Linked to UNCTAD, it helps its members to improve their investment promotion practices and to expand their network with other institutions and international businesses. It grew from a membership of 45 agencies in 1995 to 105 at the end of 1999. Its Consultative Committee is composed by FIAS, MIGA, OECD and UNCTAD.

World Bank International Bank for Reconstruction and Development – IBRD. Founded in 1944, the World Bank Group consists of five closely associated institutions: the International Bank for Reconstruction and Development (IBRD); International Development Association (IDA); International Finance Corporation (IFC); Multilateral Investment Guarantee Agency (MIGA); and the International Centre for Settlement of Investment Disputes (ICSID). The World Bank is the world's largest source of development assistance, providing nearly $30 billion in loans annually to its client countries.

WTO World Trade Organization. It is the international organization dealing with the global rules of trade between nations. Its main function is to ensure that trade flows as smoothly, predictably and freely as possible. It does this by administering trade agreements, acting as a forum for trade negotiations, settling trade disputes, reviewing national trade policies, assisting developing countries in trade policy issues, through technical assistance and training programs and cooperating with other international organizations.
Appendix 2: Current reporting requirements for FDI statistics in the United States

All foreign investments in U.S. business enterprises in which a foreign person owns a ten-percent-or-more voting interest (or the equivalent) are subject to reporting, including all ownership of real estate, improved and unimproved, other than for personal use. Reporting to the Bureau of Economic Analysis (BEA) is required pursuant to the International Investment and Trade in Services Survey Act.

Required reporting may be categorized as below, and the mentioned forms can be seen at the internet, at http://www.bea.doc.gov/bea/surveys/fdiusurv.htm:

A) Initial investment reports, for reporting the establishment or acquisition of a U.S. affiliate (see Forms BE-13 and BE-13C Exemption Claim, and BE-14);
B) Quarterly balance of payments reports, for qualifying reporters (Forms BE-605 and BE-605 Bank);
C) Annual reporting, for qualifying reporters (Form BE-15);
D) Quinquennial reporting in benchmarking surveys (Form BE-12).

A) Initial investment reports: Form BE-13, Initial Report on a Foreign Person’s Direct or Indirect Acquisition, Establishment, or Purchase of the Operating Assets, of a U.S. Business Enterprise, Including Real Estate, is required for new investment transactions, in which a foreign person, or a U.S. affiliate of a foreign person, acquires at least a 10 percent ownership interest in a U.S. business enterprise that has total assets of more than US$ 3 million or involves the acquisition of 200 or more acres of U.S. land.

Parts I through IV of Form BE-13 collect identification information and selected financial and operating data about the U.S. enterprise acquired or established. The U.S. affiliate’s industry classification is reported in Part IV and requires a breakdown of sales by industry, using categories based on the new North American Industry Classification System (NAICS). Part V requests information on investment incentives. Part VI collects identifying information about the person acquiring or establishing the U.S. enterprise, including ultimate beneficial ownership, and the cost of the investment.

It is interesting to notice, comparing to the usual procedures in Brazil, that the real estate acquired for other than personal use is considered a business enterprise and, thus, a reportable investment. Only real estate that is exclusively for personal use is totally exempt from being reported. A partial exemption (on Supplement C, Exemption Claim), whereby only minimal information must be reported, applies where the newly acquired or established U.S. business enterprise has total assets of US$ 3 million or less and owns less than 200 acres of U.S. land.

The BE-13 report is due to be filed no later than 45 days after the investment transaction occurs. The information provided in the report is used to define what other reports may be required to be filed by the U.S. affiliate.

The initial acquisition of a U.S. business enterprise may also trigger the requirement to file Form BE-14, Report by a U.S. Person Who Assists or Intervenes in the Acquisition of a U.S. Business Enterprise by, or Who Enters into a Joint Venture with a Foreign Person. This report is to be completed either by:

I) A U.S. person – including, but not limited to, an intermediary, a real estate broker, business broker, and a brokerage house – who assists or intervenes in the sale to, or purchase by, a foreign person or a U.S. affiliate of a foreign person, of a 10 percent or more voting interest in a U.S. business enterprise, including real estate, or

II) A U.S. person who enters into a joint venture with a foreign person to create a U.S. business enterprise.

Respondents to the BE-14 survey may include (but are not limited to) real estate brokers, public accountants, and attorneys.

A U.S. person is required to report only when a foreign involvement is known. It is not incumbent upon the U.S. person to ascertain the foreign status of a person involved in an acquisition unless the U.S. person has reason to believe the acquiring party may be a foreign person.

A BE-14 need not to be filed in the following situations:
- real estate is acquired by a foreign person exclusively for personal use and not for profit making purposes;
- the business enterprise has total assets, or the joint venture has a capitalization of US$ 3 million or less and owns less than 200 acres of U.S. land. (If 200 or more acres of land is acquired, then a report must be filed regardless of the dollar value of the transaction);
- if the U.S. person assisting or intervening in the sale knows that Form BE-13 is being filed, then Form BE-14 will not be required (this might be the case where the broker is managing the investment for the foreign person and undertakes to file Form BE-13). When a Form BE-13 is being filed representing a particular transaction, a Form BE-14 is not required for the same transaction.

Except as provided above, Form BE-14 is due to be filed no later than 45 days after the transaction occurs.

B) Quarterly balance of payments reports: The purpose of the quarterly report forms, BE-605 and BE-605 Bank, is to report direct financial transactions and positions between the U.S. affiliate and each foreign parent. These forms are:

- Form BE-605, Transactions of U.S. Affiliate, Except a U.S. Banking Affiliate, with Foreign Parent. Except as exempted below, this report is required each quarter for every non-banking U.S. business enterprise in which a foreign person had a direct and/or indirect ownership interest of at least 10 percent at any time during the quarter. If the ownership is indirect and the U.S. affiliate has no direct transactions or position with the foreign parent, then a report is not required if an exemption is requested. The exemption claim is made directly on the report form.
- Form BE-605 Bank, Transactions of U.S. Banking Affiliate with Foreign Parent. Except as exempted below, this report is required from every U.S. banking affiliate, both incorporated or unincorporated, in which a foreign person had a direct and/or indirect ownership interest of at least 10 percent at anytime during the quarter.

For both of these reports, the U.S. affiliate is not required to report if each of the following items for the affiliate is US$ 30 million or less:
- total assets,
- annual sales or gross operating revenues,
- annual net income (loss) after provision for U.S. income taxes.

These reports are required to be filed within 30 days after the close of each calendar or fiscal quarter, except that the report for the fourth quarter may be filed 45 days after the end of that quarter.

C) Annual reports: Annual reporting of financial and operating data of U.S. affiliates is required on Form BE-15, Annual Survey of Foreign Direct Investment in the United States. Reports on this form are required for non-bank U.S. affiliates, that is, for non-bank U.S. business enterprises in which a foreign person owns or controls, directly or indirectly, 10 percent or more of the voting securities if an incorporated U.S. business enterprise, or the equivalent interest in an unincorporated U.S. business enterprise, at the end of its fiscal year. Similarly to what was mentioned in B) Quarterly balance of payments reports, a non-bank U.S. affiliate is exempted from reporting on this form if each of those items is US$ 30 million or less.

Reporting should be on fully consolidated domestic (U.S.) basis, including in the full consolidation all U.S. affiliates owned more than 50 percent by the U.S. affiliate above in the ownership chain. Depending upon the size of the consolidated entity, either the BE-15 (LF) long form, or the BE-15 (SF) short form will be required.

The long form must be completed for each non-bank U.S. affiliate for which one or more of the three items above (total assets, sales or net income) exceeded US$ 100 million at the end of its fiscal year.

The short form must be completed for each U.S. affiliate for which one or more of those three items exceeded US$ 30 million, but no one of the items exceeded US$ 100 million at the end of its fiscal year.

The BE-15 Annual Survey is not required to be filed for a year covered by the quinquennial benchmark survey, BE-12 (i.e., 1997, 2002, etc.). Reports on Form BE-15 are required in order to update the data reported in the benchmark surveys on the financial structure and the operations of foreign owned U.S. business enterprises, except banks. The BE-15 report is due May 31, approximately 60 days after the for a given year is distributed and made available.

It must be noticed that the Claim for Exemption from Filing a BE-15 (LF) or BE-15 (SF) on BE-15 Supplement C is not an annual filing requirement for those U.S. affiliates that remain below the US$ 30
million exemption level from year to year. However, Supplement C is required to be filed when a packet of BE-15 forms is received and the criteria for filing the BE-15 (LF) and BE-15 (SF) are not met.

D) Quinquennial benchmark reports: The quinquennial survey, the Form BE-12, Benchmark Survey of Foreign Direct Investment in the United States, is a comprehensive survey of such investment, and the International Investment and Trade in Services Act requires that it be conducted at least once every five years. Because benchmark surveys are censuses, either a form BE-12 or an exemption claim is required for each U.S. business enterprise in which a foreign person owned or controlled, directly or indirectly, a 10 percent or greater ownership interest at the end of the enterprise’s fiscal year that represents a benchmark year (1997, 2002, etc.).

The benchmark survey for year of coverage 1997 was required to be filed by May 31, 1998, by all U.S. business enterprises that were foreign-owned by at least 10 percent at the end of their 1997 fiscal year. In a manner similar to the BE-15, reporting is on a fully consolidated domestic (U.S.) basis, and separate forms are provided for firms of different sizes:

- the long form, BE-12 (LF), should be completed by each non-bank U.S. affiliate for which one or more of the three items exceeded US$ 100 million at the end of its 1997 fiscal year.
- the short form, BE-12 (SF), should be completed by each non-bank U.S. affiliate for which one or more of the three items was more than US$ 3 million, but not more than US$ 100 million at the end of its 1997 fiscal year.
- the BE-12 Bank was required for each U.S. affiliate that was a bank if one or more of the three items was more than US$ 3 million at the end of its 1997 fiscal year.
- A U.S. affiliate (as consolidated) should file a BE-12 (X), Claim for Exemption from Filing BE-12 (LF), BE-12 (SF), or BE-12 Bank if each of the three items did not exceed US$ 3 million at the end of its 1997 fiscal year.

The 1997 benchmark survey introduced the new North American Industry Classification System (NAICS) as the basis for classifying enterprises reported in BEA’s surveys of international investment and trade in services. In the past, the classification was based on the U.S. Standard Industrial Classification System.

Legal authority and confidentiality: All reports are mandatory pursuant the International Investment and Trade in Services Survey Act, which states that whoever fails to report shall be subject to a civil penalty of not less than US$ 2,500 and not more than US$ 25,000, and to injunctive relief commanding such person to comply, or both. Whoever willfully fails to report shall be fined not more than US$ 10,000 and, if an individual, may be imprisoned for not more than one year, or both. Any officer, director, employee, or agent of any corporation who knowingly participates in such violations, upon conviction, may be punished by a like fine, imprisonment or both.

The Act also provides that all reports submitted are confidential and may be used only for analytical or statistical purposes. Without the prior written permission of the respondent, the information filed cannot be presented in a manner that allows it to be individually identified. The information provided cannot be used for purposes of taxation, investigation, or regulation. Copies of reports retained by the respondent are immune from legal process.
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