

Informal Summary of General Assembly Review Session 2
15 February 2008

**Chapter II of the Monterrey Consensus,
“Mobilizing International Resources for Development:
foreign direct investment and other private flows”**

I. Introduction

1. The 15 February 2008 review session on chapter II of the Monterrey Consensus was chaired by Ambassador Maged A. Abdelaziz of Egypt and Ambassador Johan L. Lovald of Norway. The meeting consisted of an initial panel discussion and an interactive dialogue by all stakeholders. The panel presentations were made by Mr. Mansoor Dailami, Manager, Office of the Vice-President for Development Economics and the Chief Economist, World Bank; Mr. Prabhat Patnaik, Professor, Centre for Economic Studies and Planning, Jawaharlal Nehru University, India; Ms. Molly Pollack, Executive Director, Chile Global Chile; Mr. John Simon, Executive Vice President, Overseas Private Investment Corporation, United States; and Mr. Rogerio Studart, Executive Director, Brazil, World Bank. (The summary views of the panelists in response to questions from the floor are also included in section II – Panel presentations). After the panel presentations, a policy discussion took place among participants, including representatives of governments as well as institutional and non-institutional stakeholders.

II. Panel presentations

Trends and policy frameworks in private resource flows to developing countries.

2. Private capital flows to developing countries have been on a strong upward trend, since 1970, with boom-bust cycles in 1982, 1984 and 1997. Such flows are being supported by domestic economic reforms, improved macroeconomic fundamentals and higher economic growth. This has been recognized by international financial markets and reflected in significantly lower bond spreads.

3. The impact of the recent financial turmoil on emerging markets have been limited so far, but private capital flows are expected to decline somewhat in the short term due to a moderation in global growth and tighter credit conditions. However, the prospects for increasing private capital flows to developing countries are positive in the long-run, driven by their age-population structures, cost advantage and promising medium to long-term outlook for investment and growth. It was noted that the current financial turmoil did not start in developing countries as was the case in previous crises.

4. Since the International Conference on Financing for Development in Monterrey, many developing countries, including a considerable number in Africa, have improved policy fundamentals and growth prospects and are attracting increasing levels of private capital inflows and a number of investment funds. Foreign direct investment has grown at

a healthy pace. The basic lesson is that countries need to have their house in order and maintain consistent and sustainable growth to attract foreign private capital. Since 2002, the percentage and absolute number of the poor has decreased in Latin America coinciding with a larger flow of FDI and other external flows.

5. Yet, gaps and weaknesses persist. While foreign direct investment has increased, it remains concentrated in a few countries. Despite the increase in private financial flows to developing countries, these have to an extent been the result of the rapid and unsustainable increase in liquidity, in the main developed financial markets including the mortgage and credit markets. Progress on reforming international trade has been limited and the international community has also failed to establish an international financial architecture that would enhance the level and stability of private capital flows to developing countries.

6. A number of developing countries have benefited from the recent increase in commodity prices. However, the extra revenue from this has in a number of instances ended up as accumulated reserves or been used to repay debt. This reserve accumulation could in many cases be put to better uses such as expanding infrastructure and productive capacity or more directly tackling poverty. In many instances, reserves exceed the levels necessary for prudential policy and protection against shocks; yet high reserve levels may generate improved sovereign ratings. Notwithstanding, countries have however established investment companies and sovereign wealth funds to use reserves for productive purposes, often investing in bond and equity markets. More consideration nevertheless needs to be given to how the high level of reserves in many countries can be employed in a manner that furthers development.

7. A significant development has been an increase in local currency debt issuance by both public and private sectors in some developing countries. The economic effect can be similar to increasing the stock of external debt when many of the creditors operating in the domestic market are foreign.

8. It is important to create a business-friendly environment in developing countries, strengthen risk-sharing mechanisms, promote public/ private partnerships and increase the domestic market through human capital development and measures to ensure that growth is inclusive. It is also needed to invest in infrastructure and foster regional integration and south-south cooperation. While developing countries should create appropriate incentives to attract productive foreign capital, they should be cautious of short-term and potentially destabilizing capital flows. In this regard, an appropriate sequencing of financial liberalization is important.

9. International institutions should support further infrastructure development, venture capital and other lending instruments, and facilitate business contacts and public/ private initiatives. They should also employ existing instruments and create new ones to expand their support to developing countries to attract stable and longer-term private capital flows.

10. The international community at large should ensure that there is an enabling international economic environment, including a fair trade system and a stable and inclusive international financial architecture. Trade agreements should consider incorporating labour standards. Countries should be on an equal footing to ensure mutual benefits from bilateral trade and investment agreements.

11. It is important that the business sector respects labour standards, becomes more socially responsible and gender sensitive and considers the environmental implications of their undertakings. They should be more transparent and respect national and international rules and principles.

12. Multilateral and bilateral efforts could strive to facilitate private capital flows to, and mobilize private resources within, developing countries. An example provided was the Small Business Finance Initiative for Latin American Banks that was recently launched by the United States, to help U.S. and local banks improve their ability to extend good loans to small businesses in Latin America. Moreover, the efficient movement of private capital needs to be complemented by the efficient movement of labor and, in this regard, developed countries should consider easing restrictions on labor mobility.

13. Further progress should be encouraged in strengthening private capital flows to low-income countries and to facilitate the financing of small and medium-sized enterprises, housing and private equity. There is also a need for cooperation to establish investment vehicles for low-income countries and to facilitate the dissemination of best practices in attracting sustainable long-term private capital from abroad.

Enhancing FDI flows and policies.

14. FDI continues to be the largest and most stable capital flow and is increasingly focused on services. While it is highly concentrated in a few large economies, as a percent of GDP its levels in low-income countries are on a par with those in middle-income countries. In absolute terms, FDI inflows are related to income per capita and low-income countries attract limited levels of these flows. Through facilitating the transfer of knowledge and technology, increasing employment generation, and enhancing productivity, cross-border linkages, competitiveness and entrepreneurship, FDI can serve to stimulate economic growth and reduce poverty.

15. In assessing the development impact of FDI, it is however important to distinguish between the different forms as there are conditions under which FDI does not contribute to development. Yet it can be particularly beneficial in the industrial sector, particularly when it is linked to manufacturing exports. However, where it takes the form of mergers and acquisitions, it may not augment the real resources of the economy; rather, its main impact might be to increase the supply of foreign exchange, leading to more accumulation of reserves or an unwanted appreciation of the exchange rate. Even greenfield investment can lead to a net employment loss when increased imported inputs replace domestic production or through the promotion of less labor intensive activities.

Moreover, in the effort of trying to attract foreign investment, countries may discriminate against local enterprises and erode the domestic tax base.

16. FDI can also be questionable in the extractive industries, where capital intensive corporations may predominate and where a large proportion of the revenues are repatriated overseas. Low income countries with natural resources should ensure that appropriate standards are being complied with and moreover should try to ensure that the revenues from this sector are employed to diversify their economy. FDI can sometimes also be volatile and negatively affected by global conditions.

17. Development finance institutions and bilateral donors can play an important role in attracting FDI to lower-income countries through risk-sharing or risk-mitigation techniques. They can also inform investors about prospects and thereby address the perception-reality gap faced by these countries and also provide finance tools, including risk insurance, that are not yet available in local markets in developing countries.

18. While certain views stressed the exploitative nature of FDI and its lack of impact on the local economy, it was also pointed out that FDI flows tend to be beneficial. In the latter case, FDI and economic growth can be mutually reinforcing. There is a need to reconcile these divergent views.

19. Developing countries must distinguish between different types of investments in international agreements. In particular, there is a need to ensure corporate social responsibility on the part of foreign investors. The Global Compact provides useful guidance in this regard. However, an assessment of the impact of patent protection in the developed world on technology transfer through FDI is warranted.

20. There is a need to reassess the measurement of FDI. There have been claims that FDI stocks, flows and profits are inaccurately measured and that 'round tripping' also distorts the actual levels of net direct investment from abroad.

21. South-South investment flows are becoming increasingly significant. They should be promoted as investors from the south possess certain advantages – use of similar technology and accounting systems, language and cultural affinity - when operating in other developing countries.

22. There may be a need for a multilateral regulatory framework for FDI. This needs to be looked at carefully given the fact that countries may need to discriminate in their treatment of different forms of FDI.

Investment in human capital, innovation and technological development.

23. There is a need for developing countries to promote innovation and technological development in order to accelerate growth. Public Private Partnerships, at all levels, can be a facilitating mechanism in this respect. The example of Chile was cited where PPPs have been successfully employed with a view to increasing the competitiveness of human

resources and productive sectors and services, by promoting and developing high impact innovations, technology transfer and management for the country. Still there is a concern with risk sharing under PPPs; the test will come in the event of an economic shock.

24. Expatriates can play a crucial role in the acceleration of technological change, business creation and investment capital in their countries of origin. They can assume the role of pioneer investors and impart market connections, technology transfer and training to their countries of origin. Their role in this regard has been illustrated in countries such as India, Ireland, Israel, China and others.

25. Developing countries also need to focus on strengthening human capital and should in particular endeavor to upgrade their stock of qualified human resources. This should be complementary to efforts to promote innovation and technological development and can be facilitated through investment in education as well as Public Private Partnerships and regional talent networks that promote knowledge exchange.

26. Countries and donors should support strategies to strengthen entrepreneurship. The highly-skilled diasporas have played an important role in this area in some countries and there is scope for learning from their experiences and scaling up their contributions in this respect. Governments could explore ways to encourage the entrepreneurial activities of diasporas in their countries of origin.

27. Measures should be undertaken to support small and medium enterprises, which are an important generator of employment creation in many countries. In this regard, where they are viable and have a beneficial impact, the backward linkages between larger enterprises and their smaller counterparts should be encouraged and supported.

III. Policy deliberations

Review of commitments and enhancing policies to mobilize international private resource flows for development.

28. Many representatives stated that the challenge was to stimulate foreign private flows which would lead to development. This also included facilitating private capital flows to a wider group of countries and maximizing their development impact. More needed to be done to create a supportive and enabling international environment for broad-based development.

29. A number of participants stressed that there need to be more initiatives by developed countries to provide incentives to their investors to invest in developing countries. At the same time, there was a need for a common understanding on what constitutes an enabling investment climate. In this respect, it was important that policy reforms relating to the investment climate are increasingly determined by developing countries, and this appeared to be happening in some instances.

30. Various representatives said that a number of LDCs have also undertaken measures to improve their business environment. Best practices need to be disseminated in this area. Of particular relevance are transparent, non-discriminatory and predictable conditions for investment, including an effective legal and regulatory framework.

31. Several delegates pointed out that, to reduce the possibility of financial crises, developing countries must have an effective system for monitoring and managing public and private sector external debt. It was also important to increase the transparency of private capital flows and to implement counter-cyclical policies that reduce the vulnerability of recipient countries to market volatility. It was also stated that short-term private capital flows are prone to instability and there might be a need for controlling such flows. It was also pointed out that credit rating agencies should rate sovereign risk according to objective and transparent criteria. It was stated that the agencies' activities should be under the auspices of international intergovernmental organizations.

32. Many delegates expressed the view that remittances have an important role in contributing to development and poverty reduction. Key issues relating to remittances included improving the quality and coverage of data on remittances, reducing the costs of remittances flows and enhancing their development impact. Overall, the legal, institutional and regulatory environments for remittances needed further improvement and one of the important issues in this regard was to strengthen the quality of local financial institutions.

33. Numerous representatives stated that it was important for policymakers at both the national and international level to strengthen oversight of financial market activities. International oversight institutions should adopt measures and strengthen existing mechanisms to prevent illicit transfers – such as tax fraud, money laundering, illegal capital flows, the abuse of transfer pricing by transnational corporations, corruption and financing terrorism. In this direction, it was suggested that countries should implement the recommendation of the OECD Financial Action Task Force.

34. Many participants emphasized the need to enhance national and international efforts to strengthen micro credit and micro-finance. Some stressed the importance of strengthening the grant element of the support provided by International Financial Institutions to development programs. The need to develop responsible and sustainable forms of tourism was also emphasized as well as the need to explore innovative initiatives to mobilize international private resources for SIDSs.

Foreign direct investment: policies to improve its development impact.

35. Many representatives underlined that the challenge was to channel greater levels of FDI to developing countries while ensuring that these investments are translated into sustainable development gains. In this respect, attention should be paid to the quality, as well as the quantity, of FDI. There was a crucial need to create an enabling domestic and

international environment to facilitate sustainable international flows of direct investment.

36. According to some speakers, attracting FDI was determined by a wide range of factors. A healthy domestic private sector is an important precondition for attracting FDI, as well as adequate infrastructure, qualified human resources and large and expanding markets. It was stated that, in many cases, lower income countries that lack large endowments of natural resources have little to offer foreign investors. For these countries, FDI can not be expected to be a prime source of development finance in the immediate period, and official resources are necessary.

37. Several participants pointed out that the measures to promote investment should not take the form of outright liberalism. Indeed, the government should play an important role in facilitating flows of FDI to selected industries and the efficient utilization of external resources required a government development strategy. The sovereignty of national policies should be guaranteed.

38. It was noted that competition for FDI had resulted in significant incentives provided by developing country governments to investors as well as through bilateral and multilateral agreements. Recent years have seen a proliferation of international investment agreements at the bilateral, regional and interregional levels. Under TRIMs and TRIPs, developing countries had been constrained in the use of performance measures which would assist in encouraging investors to contribute to developmental goals. Hence, the proper balance had to be struck between the benefits from entering into international investment agreements and the need to secure sufficient policy space.

39. Various representatives stressed the importance that domestic policies facilitate technology transfers and local productive linkages of FDI. A key factor to achieve this was an adequate business environment for small and medium-size enterprises.

40. Some participants noted that multilateral investment agreements could be less effective than bilateral investment treaties. At the same time, bilateral investment treaties should ideally be negotiated on an equal footing. Development partners should assist developing countries, and especially LDCs, in their investment negotiations so that their legitimate interests are protected.

41. It was suggested that development partners and the donor community can play a role in encouraging FDI driven by fiscal incentives from home countries. This might serve to reduce the tax concessions demanded by foreign investors from developing countries. At the same time, private companies should be encouraged not to demand deep and long lasting tax concessions when investing in developing countries.

42. A number of speakers stated that the bulk of FDI into LDCs flowed into natural resource extraction and could have a limited role as a driving engine for sustainable development. It was argued that FDI into the extractive industries can have limited impact on employment creation and the repatriation of profits by investors diluted the

benefits of their activities. Given this, it was important that recipient countries discouraged the over-exploitation of natural resources, ensured that labor standards were upheld and strengthened transparency and accountability relating to the use of revenues, taking into account the standards set in the Extractive Industries Transparency Initiative.

43. It was pointed out that FDI through mergers and acquisitions does not necessarily increase the productive capital stock. Yet, it was noted that a large proportion of FDI to developing countries since 2002 represented longer-term investment and, moreover, had gone into green-field investment, expanding the productive capacity in the economy.

44. Many representatives underscored the fact that South-South FDI had been growing significantly and could impart a positive impact on development. Developing host countries needed to consider how to fully leverage the expansion of FDI from developing and transition economies.

45. The importance of promoting internationally agreed corporate social responsibility standards, which respect the environment and workers' rights, was emphasized by a large number of speakers. Transnational corporations should undertake necessary measures to increase the development impact of their investment, especially in LDCs, and should be encouraged to contribute to the sustainable development of local communities. It was pointed out that more emphasis should be given to promoting investments in the social sectors, with a view to addressing asymmetries in resource distribution, furthering social insurance and benefiting women and poor sections of society. The work undertaken within the UN system to develop guidelines for corporate social responsibility was welcomed.

46. Several speakers noted that an efficient physical infrastructure – including transport, electricity supply and communications - is a prerequisite for creating an environment capable of attracting investment and fostering development. Public investments in basic infrastructure are important for attracting FDI and facilitating local private investment. IFIs can also play an important role in facilitating private investment into infrastructure, especially in LDCs, through mitigating the risks investors face. FDI into critical infrastructure sectors could be pursued as a joint partnership between public and private sectors. To be successful, such partnerships should be clearly defined and structured.

47. Various participants pointed out that, while there has been some reduction recently in the degree of concentration of FDI, its expansion in recent years has been uneven. Despite significant improvements in their investment climates, many LDCs receive inadequate levels of inflows and remain marginalized within global production frameworks. It was important to strengthen and explore new bilateral and multilateral risk mitigation to facilitate greater flows of FDI to LDCs.

48. A number of participants indicated that, while developing countries continue to undertake and intensify efforts to put in place improved policy frameworks for FDI, the leading reformers have not always been the leading recipients of international direct

investment. Given this, domestic reforms had to be complemented by international measures, including by global and regional development organizations, in order to encourage the diversification and transparency of sustainable long-term private capital flows.

49. Some participants noted that the creation of larger markets through regional integration among developing countries could improve the ability of developing countries, especially smaller nations, to attract FDI. It was felt that this issue, namely the creation of larger economic space through regional integration, was not sufficiently addressed in Monterrey.

50. Many representatives emphasized that technical assistance in promoting FDI and building an enabling domestic environment is an important complement to domestic efforts. Indeed, it is important for countries to recognize the synergies that can exist between ODA and FDI and harness them for attracting more FDI and ensuring its development benefits.