



World Chronicle

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**"AFTER CANCÚN: FOREIGN DIRECT INVESTMENT, INTERNATIONAL
TRADE AND THE GLOBAL ECONOMIC OUTLOOK"**

Since 2001, global levels of foreign direct investment (FDI) have decreased steadily.

Will FDI rebound in 2004? How important are the international investment agreements that influenced the decision of the developing countries to walk out of the trade talks in Cancún? What are the prospects for the economies of Latin America and Africa? Will India and China continue to attract high levels of investment and economic growth? In this edition of **World Chronicle**, these issues are explored with the help of Karl Sauvant, Director of Investment, Technology and Enterprise Development in the UN Conference on Trade and Development (UNCTAD).

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ANNOUNCER: From the United Nations in New York, an unedited interview programme on global issues. This is **World Chronicle**. And here is the host of today's **World Chronicle**.

LITTLEJOHNS: I am Michael Littlejohns and this is World Chronicle. Global Foreign Direct Investment, already down by more than 40 percent in 2001, fell by another 21 percent in 2002. For 2003, it appears that investment levels have stabilized somewhat, but it's probably fair to say that the slump in Foreign Direct Investment – FDI – continues. What are the prospects for the global economy in 2004? To help us answer that very big question, our guest today is Karl Sauvant, Director of Investment Technology and Enterprise Development in the UN Conference on Trade and Development (UNCTAD). Joining us in the studio are Ricardo Alday of the Mexican News Agency/NOTIMEX, and Judy Lessing of Radio New Zealand. Mr. Sauvant, welcome to **World Chronicle**.

LITTLEJOHNS: Mr. Sauvant the breakdown of the World Trade Organization meeting in Cancun, Mexico recently was a severe blow and it's been analyzed in many different ways, mostly negative. What effect, if any, do you foresee on foreign direct investment, FDI.

SAUVANT: Well the issue of to what extent foreign direct investment is affected by the talks in the WTO and by the negotiations of WTO has to be seen in a broader context - I mean the context of what determines flows of foreign direct investment. In other words, why do companies invest where they invest? And there, the principal determinants are economic in nature, meaning whether a country, an economy is growing, how big the market is, how easy it is to invest, how open the economic sectors are, and the number of how good the infrastructure is, how high skill levels are, and related types of economic factors which basically determine whether or not foreign direct investment will take place. The regulatory framework, it's a national and it's a regional entity at the international to multi-lateral level and best can be enabling in the sense of allowing firms to invest. But whether they invest is really a question of whether the economic factors are right, and in that sense, I think any predictions or estimations as to foreign direct investment flows over the next year or so really depends on our evaluation of the economic variables.

LITTLEJOHNS: Mr. Sauvant, a sad fact of life -- some people might think it's sad anyway -- is that money seems rush to a country the minute that there's a chance that it is going to produce oil. Case in point, Chad, the African country, which received I think nine hundred million in direct investment where some other poor countries in Africa received practically nothing. Does UNCTAD like that situation? Does it not perhaps upset the balance?

SAUVANT: Well, you are obviously right that having natural resources, in particular natural resources that are in demand, is always an attractive factor for foreign investors to come in. And the countries who have that of course are the fortunate, but for many other countries and in particular in Africa, which are not that fortunate, one has to make extra effort in terms of helping countries to attract foreign direct investment and that is indeed one of the functions of UNCTAD in terms of helping developing countries to review the regulatory framework for foreign direct investment, and then develop an integrated strategy how that framework can be improved in light of the objectives of the country to attract foreign direct investment and to benefit from it. And for that purpose, UNCTAD has indeed a technical assistance program that spans a number of areas relevant to this task.

ALDAY: Mr. Sauvont, as Michael referred in the beginning of the show, foreign direct investment has been going down, has gone down for a second year in a row. What is the impact of this trend into the Millennium Development Goals set forward by the UN?

SAUVANT: The down turn of foreign direct investment by 40% in 2001, and now by 20% in 2002, is really the steepest downturn in at least 30 years. And the immediate implication is that there are fewer resources or less resources available to countries, in particular to developing countries, in terms of capital, in terms of technology, in terms of skills, in terms of access to markets to promote their own development, and to benefit from foreign direct investment, which of course requires extra policies. And to that extent and to the extent that these resources, from capital, from technology --two skills actually contribute to fulfilling the Millennium Development Goals, and they do because all of these factors play a role in terms of stimulating growth, obviously, the downturn does not help meeting the Millennium Development Goals.

ALDAY: But how did you go ahead with this formula that you are referring to when markets could've been closed for the poorest countries, when their products are still subject of high tariffs and barriers, which goes back to the point of Cancun?

SAUVANT: Well, you know, if you look at the poorest countries, you can take most of the African countries, most of the African countries are actually among the least developed countries, they have access to markets, they have access to the US market, to the European market, and to the Japanese market for most products. But the problem there is not access for these countries, the problem is the supply capacity. And I think for many of these countries increasingly, attention has to be given to the question how can they develop supply capacity, of course, first of all through domestic investment because foreign direct investment can only be a compliment to domestic investment in order to take advantage of the possibilities offered

by the multilateral trading system or, for that matter, by regional or bilateral trading systems. So the problem is, for the least developed countries in many cases, really primarily one of having the capacity to produce goods and services, which are in demand in the world market.

LESSING: But how do you do that? How can you help countries to be able indeed to fill large orders because that's one of the things that you're talking about? If the cotton farmer in Central Africa simply can't produce anymore, what do you do?

SAUVANT: Well, I think the basic answer to that, it's easier said than done, I realize that, is enterprise development in the sense of helping the countries involved to develop a vibrant domestic enterprise sector. But that's not enough, obviously, that's not enough assuming at least that markets are open. To break into the highly competitive markets of the developed countries is not an easy task; and I think therefore foreign direct investment has a role to play because through international supply chains the companies of developed countries have access to markets, and in fact, if you look at the big success stories of among – most of the big success stories not all of them - among the developing countries in terms of increasing exports, a good part of these success stories are actually driven by the foreign affiliates of transnational corporations. Take for example China. China has increased its exports from very little to over 250 billion dollars in the year 2002. Some half of these exports are actually exports by foreign affiliates, established in China, servicing markets internationally. So the point here would be to look at foreign direct investment at least in certain areas, as a tool for a country to help you to break into international market, but its not a substitute for developing the domestic enterprise sector.

LESSING: You talked about UNCTAD helping countries to deal say with their own regulations, which may be barriers to this kind of development. Can you give any specific examples of that?

SAUVANT: Well, there are lots of barriers. It starts by for instance a country saying I do not want to have foreign direct investment in certain sectors, which is perfectly legitimate. I mean even highly liberalized countries like the United States for instance says, I do not want to have more than 75% foreign ownership let's say of airlines, for a number of reasons. So it's perfectly right to have that. But then it's a question very often also of getting the permission to do certain things to have access to land, to get licenses to import and to export, and there is a whole slew of regulatory and administrative barriers which exist in some countries, and which do not necessarily help inward foreign direct investment, but even if these barriers alone, cannot be...are not decisive if the economic factors are right. For instance, I can imagine that

the regulatory framework in China could be better, but nevertheless China has been highly successful in attracting foreign direct investment. In turn, we should not only focus on host countries, the recipients of foreign direct investment. One should perhaps also ask what can home countries, in other words, home countries of the multi-national corporations do in order to encourage foreign direct investment? And there are number of things which could perhaps think about, you know, many countries do already insurance of output investment, provide information. And it's something perhaps which also requires some attention because after all, there are three players so to speak: the host country, the home country, and the multi-national corporation itself, which is involved in the investment process and attention should not only focus on what the host country can do in order to attract foreign direct investment.

LITTLEJOHNS: In international organizations nowadays, and the World Trade Organization is a good recent example, [there] seemed to be more disagreements than there are agreements. What about UNCTAD? Are you generally able to reconcile the differences between the rich countries, and the poor? I attended the first UNCTAD meeting in the 60's and the mantra was of course, trade, not aid. Now, is that as strong now as it was then?

SAUVANT: Well, the disagreements between developed and developing countries - and they are real because you have countries in different situations with different interests - I think are particularly relevant and come to the forefront when you have negotiations. But you do not have an UNCTAD compared to the UNCTAD of the 1964 or thereafter. You do not have negotiations in UNCTAD anymore, you have consensus building, you have discussions and of course, in these discussions you have different views expressed by various groups of countries, you have policy analysis in terms of trying to identify what the issues are, and you have perhaps consensus-building in terms of seeing how you could address some of these issues that require international attention. So, in that sense, the differences in opinion and the differences of perspective do not clash in UNCTAD today as they used to clash in the past.

LITTLEJOHNS: This is **World Chronicle**, our guest is Karl Sauvant, Director of Investment Technology and Enterprise Development in the UN Conference on Trade and Development, UNCTAD.

ALDAY: Mr. Sauvant, Latin America is one of the regions of the world that are more reliant on and more depend on foreign direct investment. How does the current slump affect the outlook in the short and medium terms? And are there any sectors that are particularly hit by it?

SAUVANT: Well, we had of course a decline in Latin America as well, and in fact not only in terms of absolute amounts of foreign direct investment going to Latin America, but also in terms of the number of countries which received less foreign direct investment in 2002 than in 2001. But let me perhaps put this thing in perspective in two ways: the first one is, that actually foreign direct investment flows in 1999 and 2000 were unusually high. In 2000, there were 1.4 trillion dollars and that was largely driven by mergers and acquisitions between developed countries. So the decline to a certain extent reflects that, if you want, the cross border merger and acquisition bubble has been deflated, and the figure of about 650 billion dollars of investment flows, which we have in the year 2002 is roughly equivalent to what we had in 1997, that's one thing. The other thing is we should not forget that foreign direct investment is not perishable, it rather builds a stock. And in fact, we estimate that the stock of foreign direct investment is approximately 7 trillion dollars, which creates sales worth of about 18 trillion dollars, which in turn is more than twice as much as exports. So in that sense, as long as foreign direct investment flows remained positive, the stock of foreign direct investment and if you wish the size of international production continues to expand and everything that goes with it, both in terms of the positive things, but also of the negative things, which you can have in terms of restricted business practices or crowding out in host countries. Now, back to your question of Latin America. Obviously to the extent of Latin America and - in the case of Latin America incidentally the boom of the year 2000 was also fuelled to some extent by cross border mergers and acquisitions which took the form of participation in privatizations, especially for instance in Brazil. Brazil had investment in-flows of approximately 33 billion dollars in the year 2000. In the year 2002, we expected to be perhaps 10 billion dollars, maybe 12 billion dollars, and to a large extent, that is explained by a decline in the privatization program. What effect does that have on Latin American growth? And the expected growth? To the extent that foreign direct investment indeed brings capital technology access to market, obviously a decline of resources will not help to rekindle growth, but lets keep in mind foreign direct investment is only a compliment to domestic investment.

LESSING: When you wrote the report, and reports take time to put together, you are predicting an upturn in foreign direct investment. Do you still feel as confident today?

SAUVANT: Yes, I would think that we expect the year 2003, that fully in 2003, that the decline has bottomed out. Its always of course difficult to know the figures before the end of the year, but nevertheless we expect that the decline has bottomed out, and we're cautiously optimistic that [in] the year 2004, we'll see an upswing, and I think the extent to which you will

have an upswing will depend primarily on the over-all economic performance of the key developed countries. That will be the key determinant - [it] goes back to the discussion we had earlier about what are the key determinants driving foreign direct investments.

LESSING: So, that's the United States and the Western Europe?

SAUVANT: The United States and the Western Europe in particular, yes.

LITTLEJOHNS: We haven't spoken about the Middle East and, specifically, Iraq, where a number of countries seemed to be only too eager to get in to do some investing because they're rather afraid that the United States is getting the lion's share. Does UNCTAD as an institution have any influence on that?

SAUVANT: Well we had thought of trying to include a box on the prospects for foreign direct investment in Iraq, but after having talked to companies and experts in the field, we decided not to do so, because it's simply too uncertain. I think until the situation has stabilized, it is very difficult to see what will happen in terms of foreign direct investment in Iraq in particular when it comes to larger scale projects.

LITTLEJOHNS: What about the other Middle East countries?

SAUVANT: Well, Saudi Arabia has indicated, seems to be moving to a liberalization of its policy as far as oil is concerned, and there are quite substantial estimates that Saudi Arabia might invite and might attract substantial amounts of foreign direct investment, but that will all depend on how the regulatory regime in Saudi Arabia develops, and to what extent then companies will be interested to go in.

ALDAY: Do you foresee China continuing to be a magnet for foreign direct investment the following years, and, at the same time, a threat to other economies that badly need these resources?

SAUVANT: Well, I agree with the first half of your statement, but not necessarily with the second half. Yes, China has been, in fact among the other countries in the year 2002, China has really been one of the best performing countries toward attracting investment among the developing countries. And we expect it to remain a magnet, partly also because of the liberalization of the investment regime in follow up to accession of China to the WTO, and the opening of some sectors, but most of all because of the rapid economic growth that the country is experiencing, and that attracts investment from all over the world. Now, is that a threat to other countries? I rather doubt it, because I don't think foreign direct investment is sort of a zero sum game in the sense if, if I invest in China I do not invest somewhere else. The amount of foreign direct investment as a percentage of total investment, world investment is about 12%,

so from that point of view, you could imagine. But in some countries like the UK, its at 40 or 50%, so from that point of view, you could imagine that you could have billions and billions of dollars going into China in addition, but at the same time having the same amount or more going into other countries if they are attractive as far as economic determinants are concerned, the others come back to the bottom line for companies that determines whether or not investment will take place. But let me mention one other thing about China because its interesting: we're always focusing on inward investment, China is becoming also an outward investor, in the sense that Chinese companies also are subject to the competition in the open world economy and have to be present there, not only through exports but also through foreign direct investment to service markets who have access to technology and skill. And you know, I would expect China over the next few years to become a not unimportant outward investor; at the moment its about 2 billion dollars or something like that, which is not very much, but I expect it to increase.

LESSING: The United States dollar has been stronger than it is right now. It also of course will fluctuate, but what's the importance of a weak US dollar? How does that affect foreign direct investment, and the general things that you are covering in your report?

SAUVANT: Well, a weak currency, let's say a weak dollar would make it easier for foreigners to invest in the United States. But if you look at foreign direct investment in the United States in the year 2002, it was low, it was at the lowest point in many years, so -- which points to something -- and incidentally I don't expect that to continue. In fact during the first quarter of 2003, investment in-flows were three times what they were during the first quarter of 2002, so we expect the US, which was last year number two in terms of foreign direct investment, to become again number one in terms of attracting foreign direct investment. But I think it points to another issue which is very important, that foreign direct investment decisions are not so much driven by regulatory frameworks or, for that matter, by currency changes, but rather by broader corporate strategies. You have to be in China, because it's a big market, expanding market, you know, and therefore you have to be there. And you have to be in the United States if the dollar is - never mind if the dollar is cheap or relatively expensive, you have to be there because it's the most competitive market in the world, the biggest market in the world. Now, that's not to say that exchange rate movements are irrelevant, they may for instance influence the timing -- if a particular acquisition in mind or a particular project in mind, you might undertake that when the dollar is cheap, but first, the broader strategic and economic, you know, factors have to work out.

LITTLEJOHNS: India is an important player in information technology. Is UNCTAD encouraging other countries to explore the possibilities in that area?

SAUVANT: India is a very interesting case, you are absolutely right. In particular, in information, communication technology and software, you know, and the case is, I think outstanding performance of India in that area is well known. Incidentally, it's an example also of showing where foreign direct investment had an important role to play in terms of stimulating exports in software from India, not only foreign direct investment but it did play a role as well. But [what] I think the Indian case does is, it draws your attention that there are new areas where investment is possible, and in particular those areas in the services sector, which basically can be traded over communication lines, and in that sense, software is a good example, call centres are another example and, I would venture to guess, increasingly all services or parts of services products, that can be produced somewhere else, and then sent to headquarters or to another affiliate via telecommunication lines. So that in the end, you might see, we might be at the beginning of a process that has fairly far advanced in the manufacturing sector, namely that you split up the value added chain, you produce each part where you can produce it best, and then you assemble it at whatever place you want to assemble it. And my feeling is that you might have the same development in the services sector taking place so that you're getting increasingly an international division of labour and services.

LITTLEJOHNS: We have only few seconds left. Do you foresee inflation roaring back as a major global problem?

SAUVANT: Well, at the moment, the opposite seems to be more of a concern to people...

LITTLEJOHNS: But isn't that a reason why perhaps it completely should be the opposite?

SAUVANT: We'll have to see, certainly at the moment it doesn't look as if inflation is something which is looming as a major threat of economics, but rather it is I think an effort to re-stimulate economic growth.

LITTLE JOHNS: Mr. Sauvant that's all the time we have, thank you for being with us on this edition of **World Chronicle**. Our guest has been Karl Sauvant, Director of Investment Technology and Enterprise Development in the UN Conference on Trade and Development, UNCTAD. He was interviewed by Ricardo Alday of Mexican News Agency/NOTIMEX, and Judy Lessing of Radio New Zealand.

I am Michael Littlejohns, thank you for joining us. We invite you to be with us for the next edition of **World Chronicle**.

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