

## Investment<sup>241</sup>

### 9.1 Introduction

With the increasing globalisation and liberalisation of financial markets, investment policies have become even more important for the South. TNCs from Europe are among the major investors in developing countries, and the EU is an important source of Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI) in the South. The EU is also a proponent of the regulation of investment in a multi-lateral framework. For European companies high interests are at stake in gaining access to foreign markets – in fierce competition with the US and Japan. Moreover, with the opening of the international financial markets, short-term FPI, or speculative capital, has become a source for making profits.

Investment flows are seen as being at the heart of economic growth and the spearhead of globalisation. At the same time, the movements in the international financial markets have been the most important factor leading to the South-east Asian financial crisis. Clearly the Asian crisis of 1997-1998 is not a phenomenon that stood by itself. It followed the Mexican crisis in 1995, and was followed in 1998 by a crisis of the financial markets in Brazil and in Russia. These crises are not yet over, and are by no means resolved; on the contrary, the crises have deepened in the last twelve months.

This chapter will look at the role of the EU in investment and investment policies, with a particular focus on EU-Asia relations. The Asia-Europe Meeting (ASEM), a grouping of 25 European and South-east Asian countries and the European Commission has an important focus on trade and investment. These policies are closely inter-linked and mutually dependent.<sup>242</sup> ASEM also sees these as the crucial areas for the expansion of co-operation in the next century:

“Asia and Europe should now take a quantum leap in co-operation regarding trade, investment and infrastructure.”<sup>243</sup>

At present, the Asia-Europe Investment Promotion Action Plan (IPAP) of the Asia-Europe Meeting (ASEM) is one of two major practical outcomes of an informal process initiated in 1996. The other major economic outcome of ASEM is the Trade Facilitation Action Plan (TFAP), discussed in chapter 8. Taking IPAP as a case study, this chapter assesses which investment policies contribute to social development.

## 9.2 Foreign Investment

Foreign investment can be divided roughly into two distinct types: Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI). FDI is defined as an investment involving a long-term relationship and reflecting a lasting interest and control of a resident entity in an enterprise resident in an economy other than that of the foreign direct investor. The investor's purpose is to have an effective voice in the management of the enterprise. This can take place through the acquisition of an existing firm or through the creation of a new firm. The latter, known as "green-field" investment, involves the creation of new productive capacity. FDI flows comprise equity capital (purchase of shares of enterprise in another country), re-invested earnings (the direct investor's share of earnings not distributed as dividends by affiliates or earnings not remitted to the direct investor), and intra company loans or debt transactions between the direct investors and the affiliate enterprise.<sup>244</sup>

Mergers and acquisitions (M&A) have as their immediate objective the joining together or the take-over of existing firms and, by extension, their existing productive capacity. Acquisition of 10% or more of the voting stock is commonly accepted as demonstrating the aim of acquiring a lasting interest in the enterprise. Foreign investment involving the acquisition of less than 10% of the shares of an enterprise is classified as portfolio investment. It should be noted that the 10% benchmark is not an absolute figure but a guide in distinguishing the two types of investment. FDI stock is the value of the share of capital and reserves attributable to the parent enterprise, plus the net indebtedness of the affiliates to the parent enterprise.

FDI is set within a longer-term perspective and is part of an overall corporate strategy. FDI involves a package of intangibles such as technology, innovation, organisational and managerial practices and skills, human resource development, access to markets and forward and backward linkage with domestic enterprises.<sup>245</sup> The extent to which these potential intangibles are translated into practice in the host country is of crucial importance in assessing the developmental impact of FDI.

FPI, by contrast, is designed primarily to secure short-term profitable returns for the investor. As a result, portfolio investment is particularly volatile – movements in financial markets generally result in extremely skittish behaviour, and the 'herd instinct' is triggered by even a small movement in the market or a 'feeling' of lack of confidence. The sudden withdrawal of FPI, or the threat that this might happen, played a crucial role in the emergence of the financial crises around the globe in recent years.

Whilst FDI is generally more stable and able to weather market vagaries, this is not always so. This is particularly the case with Export Processing Zones (EPZ)

where the host government frequently provides infrastructure, tax incentive schemes, and a particular segment of a generally invisible workforce (predominantly young women between the ages of 16-24). EPZs have few, if any, backward linkages to the host domestic economy: they import most of their requirements and, by definition, export the finished product. In 1996 there were 225 EPZs in Asia. FDI in such zones has proven particularly footloose, with companies relocating swiftly to take advantage of – for the TNC – better incentives such as greater tax incentives, lower wages, lower labour and environmental standards.

Any host country obviously prefers greenfield FDI, particularly as an impetus to the local economy, to employment creation and, hopefully, to technology transfer. However a large proportion of FDI is in the form of mergers and acquisitions (M&A) and cross border majority purchases. Cross border M&As accounted for the bulk of the increase in FDI flows and their value in relation to total FDI inflows rose from 49% in 1996 to 58% in 1997, representing the highest share reached in the 1990s. In 1997 total cross-border M&A transactions worldwide amounted to a record level of \$342 billion with banking and insurance becoming the dominant industries for M&As.<sup>246</sup>

Although FDI is defined as investments made with a view to a long-term involvement in the host country, divestment of FDI also takes place quite frequently and for a variety of reasons. These can include intensified competition in the host country, mismanagement, erroneous assessment of demand, decrease in profits due to wage rises, over-investment, and changes in the regulatory environment. But divestment can take place even when foreign affiliates are a continuing success and relate more to a broader corporate strategy of reorganisation, restructuring and ‘down-sizing’. As with investment, divestment can fluctuate from year-to-year.

### *9.2.1 Capital flows*

FDI has become increasingly important in terms of financial flows to developing countries. In overall terms a shift in comparative value can be noted from aid flows to developing countries towards private flows. Market flows rose from one-third to two-thirds of the total between 1988 and 1996. Meanwhile aid flows fell in real terms (see annex 12).

FDI has been increasing steadily throughout the 1990s and, in 1997, seemingly largely unaffected by the Asian crisis, increased to \$400 billion, with outflows reaching \$424 billion. In 1997 FDI outflows from the European Union were \$180 billion, compared to \$100 billion in 1990, with increased orientation to developing countries, especially South-east Asia. Whilst developed countries, with more than 66% of world inward FDI stock and 90% of outward stock, dominate the global

picture, their dominance is being eroded. Developing countries accounted for nearly 37% of global FDI inflows in 1997 (\$149 billion), increasing from 17% in 1990 (\$34 billion).

This upward trend in investment flows further supported the expansion in international production. Sales of foreign affiliates have grown faster than world exports of goods and services. The ratio of the volume of world inward plus outward FDI stocks to world GDP has grown twice as fast as the ratio of world imports and exports to world GDP. This suggests that the expansion of international production has deepened the interdependence of the world economy beyond that achieved by international trade alone.

As the following table shows, between 1992 and 1996 FDI inflows into industrialised countries almost doubled, while FDI inflows into developing countries almost tripled, with a particularly steep rise in FDI to Asia. Asia accounted for more than 50% of all FDI inflows in developing countries.

TABLE 19 *Foreign Direct Investment (FDI) Inflows 1985-96, in US\$ billion*<sup>247</sup>

	1985-90	1992	1994	1996
World	141.9	173.8	238.7	349.2
Developed Countries	116.7	119.7	142.4	208.2
Developing Countries	24.7	49.6	90.5	128.7
Africa	2.9	3.2	5.5	4.9
Latin America	8.1	16.2	27.0	38.6
Asia	13.5	29.6	57.5	84.3
Central & Eastern Europe	0.4	4.4	5.9	12.3
Least Developed Countries	0.6	1.5	1.0	1.6

Most of the investment outflows come from the EU, Japan and the US, and its destination is highly concentrated. Indeed, in 1996, the top five host countries – China, Brazil, Singapore, Mexico and Indonesia, accounted for almost 60% of all the FDI inflows in developing countries. China alone accounted for 30% of all FDI inflows in developing countries with a total of \$40.8 billion.<sup>248</sup> With the exception of China and Singapore, FDI often comprises a large part or even the largest part of investment to developing countries as shown in table 20.

In terms of the most important host countries for EU FDI in the period 1992-96, the United States accounted for 44% of non-EU outflows, followed way behind by Switzerland (6%) and Hungary (4%). By contrast Japan received only 1% of EU FDI. The 70 countries of Africa, Caribbean and Pacific accounted for only 1% of EU FDI and China also accounted for 1%. ASEAN countries received 7% of EU FDI.

TABLE 20 *Average flows of FDI and FPI to selected countries (1992-1997), in US\$ billion*<sup>249</sup>

	FDI	FPI	FPI as percentage of total investment
Singapore	6.6	1.1	14
China	2.4	0.8	25
Indonesia	3.6	2.9	45
Mexico	8.2	10.7	57
Thailand	1.9	3.3	63
Brazil	6.3	11.9	65
Argentina	4.3	10.0	70
South Korea	1.4	11.9	89

The United States was the most important investor in the EU during 1992-1996, accounting for 59% of EU inward flows, followed by Switzerland (15%), Japan (6%) and Norway (3%). More than 50% of EU assets were held in just 3 countries – the United States (44%), Switzerland (10%) and Australia (5%).

The ‘Asian tigers’ first drew attention to the potential of developing countries as serious targets for investment. In recent years China – though not labelled a ‘tiger’, has joined this club as a major recipient of FDI, particular in comparison to other developing countries. A new record level of \$45 billion in FDI flows to China contributed to the 9% increase in total FDI flows to Asia and the Pacific in 1997. With \$87 billion in 1997, Asia and the Pacific accounts for nearly 60% of FDI inflows received by all developing countries, and for over 50% of developing country FDI stock. South-east Asia, most affected by the financial crisis, saw a small increase of 6% to \$82.4 billion in 1997.

From an investment point of view, China is a particularly interesting case. It has experienced an extraordinary FDI boom in the 1990s but this now shows signs of coming to an end. Whilst FDI inflows to China increased by 11% in 1997, this is a small increase when compared to an average of 147% in 1992 and 1993.

In conclusion, the EU outflows of FDI have increased rapidly, with dramatic increases to Asia and China. As shown in annex 14 the inflows of FDI from Asia in the EU are negligible, with the exception of Japan. While inflows of Japan are significant, the outflows to Japan are fluctuating and less extensive. China is clearly the most important destination of EU FDI to Asia. EU outward flows to Hongkong, Singapore, South Korea and Taiwan have also increased quite rapidly.

### 9.2.2 *Transnational Corporations*

Transnational Corporations (TNCs) are enterprises comprising parent enterprises and their foreign affiliates. TNCs can be categorised in terms of foreign assets – showing the value of the investments abroad in financial terms alone. The concept 'transnationality' is also used to categorise TNCs, as a means of incorporating other aspects of globalised production, notably employment.<sup>250</sup> Figures aggregated by industry identify that the food and beverage industry rank relatively high if measured by transnationality, against a comparatively lower ranking in terms of foreign assets. On the other hand, the electronics and electrical equipment sector and the oil sector, have a proportionally high amount of foreign assets against a relatively modest score on 'transnationality'. The concept of 'transnationality' is becoming more important in the face of globalisation as it is a measure of the global spread of production, rather than of assets alone. The companies that score high on the transnationality index are likely to have a better impact on development than those investors that rank high only as a result of the size of their foreign assets abroad. Between the two indexes the country origin of TNCs from industrialised world show marked differences, with companies from North America and Japan dominating the foreign assets index, while companies from mainly small European countries being prominent in the transnationality index (see annex 13).

TABLE 21 *Averages in transnationality and foreign assets by industry 1996*<sup>251</sup>

<i>Industry</i>	<i>Average Trans-Nationality as %</i>	<i>Foreign Assets \$ billion</i>	<i>Foreign Assets as % of top 100 Foreign assets</i>
Food & Beverages	67.2	171	9.5
Chemicals & Pharmaceuticals	65.3	247	13.7
Miscellaneous	62.4	141	7.8
Electronics & electrical equipment	52.8	357	19.7
Oil, petroleum & mining	52.1	331	18.3
Telecommunications	47.9	50	2.8
Automotive	43.8	381	21.1
Diversified	39.2	73	4.0
Trading	29.0	56	3.1
TOTAL	54.8	1 808	100.0

Using either index, corporations from developing countries are largely absent from the list of major TNCs. Only two, Daewoo from South Korea and Petr leas de Venezuela, are among the hundred largest companies, measured by foreign assets. Daewoo, with foreign assets of less than 20% of General Electric, is forty-third and Petr leas de Venezuela is in 73<sup>rd</sup> place on the top-100 list of TNCs.

What is striking, however, is the prominence of Asian-based TNCs and in particular those from China and Hong Kong in the top lists of both indexes for TNCs from developing countries.

TABLE 22 *Top 5 TNCs from developing countries in terms of degree of trans-nationality, 1996*<sup>252</sup>

Ranking by Transnationality Index	Corporation	Country	Industry
1	Orient Overseas International	Hong Kong, China	Transportation
2	Pan-American Beverages	Mexico/Panama	Beverages
3	Guangdong Investments	Hong Kong, China	Miscellaneous
4	First Pacific Company	Hong Kong, China	Electronic Parts
5	Sappi Ltd	South Africa	Paper

If ranked by foreign assets the table equally shows the importance of emerging Asian corporations, and of China in particular. The top ten TNCs from developing countries ranked by foreign assets in 1996 as shown in table 23, lists seven corporations of South-East Asian origin.

In conclusion, of the top hundred ranking of transnational corporations in terms of foreign assets there are only two companies from developing countries. This confirms the picture that, while the EU volume of FDI in Asia has grown considerably, Asian FDI in Europe is relatively unimportant. In that sense the investment flows rather follow a one-way stream. Companies of developing countries investing abroad are relatively concentrated. Rankings of TNCs from developing countries show the relative importance of Hongkong/China. Given the fact that China is not a member of the WTO this is an important issue both for developed and for other developing countries.

TABLE 23 *Top 10 TNCs from developing countries in terms of foreign assets, 1996*<sup>253</sup>

Ranking foreign assets	Corporation	Country	Industry
1	Daewoo	South Korea	Diversified/Trading
2	Petróleos de Venezuela SA	Venezuela	Petroleum
3	Cemex SA	Mexico	Construction
4	First Pacific Company	Hong Kong, China	Electronic Parts
5	Sappi Limited	South Africa	Paper
6	Acer Group	Taiwan Province of China	Electronics
7	Jardine Matheson Holdings	Bermuda	Conglomerate/ diversified
8	China National Chemicals	China	Diversified/trading
9	China State Construction Engineering Corporation	China	Diversified/ construction
10	Campania de Telecomunicaciones de Chile	Chile	Utilities

Jardine Matheson Holdings now based in Bermuda was until recently Hong Kong based but relocated prior to the colonies reversion to China.

### 9.3 The Asia crisis

The misnamed 'Asian' crisis, precipitated by the devaluation of the Thai Baht on 2 July 1997, tended to be seen, particularly by the IMF, as a temporary – albeit expensive – blip on the radar screen of globalisation. The solution proposed was a short-term bail out package conditional on stringent domestic reform in the Asian economies and posited on the belief that a retreat into protectionism should be avoided come what may. On the contrary, the trade and financial liberalisation process, which had characterised the dynamic 'Asian tigers', should be continued at all costs.

Whilst the crisis was different in each of the most affected countries: Thailand, Malaysia, Indonesia, Philippines and South Korea – there is little doubt that foreign investment played a crucial role. There are a number of related problems. Foreign investment has been supply-driven, rather than demand-driven. The inward flow of capital has been seeking a profit, and has been restlessly seeking the highest rate of

return. This inflow of capital has created its own momentum so that the recorded high rates of economic growth have overstated the real growth of the economy. Little of the inward foreign capital was actually invested in productive capacity. On the contrary it led to rapidly increasing asset values which created the illusion of growth.

At the same time, structural adjustment programmes (SAPs) implemented by national governments to secure loans from the IMF and elsewhere, have required policies that have led to an actual contraction in the real demand within the domestic economy. A re-orientation towards export-oriented industry, required by the SAPs as a means of generating external financial resources to service the external and internal public debts, encouraged TNC penetration. Domestic capital, particularly in SMEs and micro-enterprises, was faced with contracting demand and inflating asset values. Loan availability was then determined by asset value, not by productive capacity.<sup>254</sup>

When Thailand devalued the Baht in 1997, foreign investors, fearing rapid devaluation of their assets rushed to withdraw from the Thai economy. Since the Asian miracle was based on short-term speculative investment the collapsing confidence in the Thai economy quickly spread across the region. The crisis was compounded by an expected contraction of the regional trade, which has accounted for much of the actual productive growth achieved in the export sectors within the region's economies.

Developed countries felt themselves armed against any adverse economic fallout, particularly in the European Union, which assumed that the advent of the Euro would prove an effective barrier. As the crisis spread across Asia and to Russia and Brazil, and as economic slow-down began to effect other countries, this received wisdom came under increasing scrutiny, including in the IMF itself. Not only did it become increasingly apparent that the IMF recipes of structural adjustment contributed to the crisis, but also that the IMF misdiagnosed the crisis as overspending in the public sector and prescribed further cuts in public spending. This further contracted the domestic economies, and, investors fearing that the bubble might burst, rushed to withdraw their investment. The IMF did not calm the situation but created further panic.<sup>255</sup>

This can be well illustrated in Indonesia. Here the problems in the financial sector were exacerbated by rising external liabilities, increased levels of defaulting private sector loans, and a lack of confidence in the government's ability to resolve the problems. This resulted in overvalued assets and currency. The excessive amounts of FPI created further instability. When the crisis came over two thirds of the country's banks were affected, and more than \$2 billion was suddenly withdrawn from the banking system. The IMF's treatment of the crisis increased the problems and this was recognised in an internal memorandum:

“[A]n important element of the IMF’s rescue strategy backfired, causing a bank panic that helped set off financial market declines in much of Asia (...). These closures, far from improving public confidence in the banking system, have instead set off a renewed ‘flight to safety’.”<sup>256</sup>

The unfortunate misdiagnosis by the IMF raise many important questions concerning the way in which the crisis was examined, and how its policies are determined. It certainly calls into question the basis on which the IMF operates – including its relationship with financial owners, speculators and its key shareholders – the US and Europe.<sup>257</sup> In the circumstance it is extraordinary that – without further evaluation, ASEM leaders:

“.. agreed that it was important to reinforce the role of the International Monetary Fund at the centre of the global response to what is a global concern.”<sup>258</sup>

In this context it is also striking that the ASEM Trust Fund – established by the 2<sup>nd</sup> ASEM Summit in order to provide “*technical support for restructuring their financial sectors*” and “*for addressing the social effects of the crisis*”,<sup>259</sup> was placed within the World Bank, rather than, for instance, within the European Commission. This graphically illustrates the EU’s implicit acquiescence with the ‘Washington consensus’ – between the International Financial Institutions and the industrial financial lobby based in Washington.

### 9.3.1 *Effects on investment flows*

The effects of the financial crisis on investment demonstrate a sharp distinction between FDI and TPI related to specific patterns of inflows and outflows. FPI has fallen sharply in the five most affected Asian countries whilst foreign bank loans have plummeted. However, FDI flows to the most affected crisis countries increased in the short to medium term. This was a result of decreased costs in establishing or expanding production facilities due to asset depreciation and currency devaluation, and the fact that many companies were on the verge of bankruptcy, given the heavy indebtedness of domestic firms and their reduced access to liquidity.

Consequentially M&As, led by companies from the United States and Singapore, have increased in the most crisis-affected countries since the onset of the financial crisis. Many of these sales were full acquisitions.<sup>260</sup> This has been the case particularly in South Korea and focuses especially on domestic firms, which are likely to go bankrupt.

Thus, export-oriented firms – in particular efficiency seeking mobile ones – have especially benefited by lowering costs of production, including of course real

wage costs. In Thailand, for example, FDI in such labour-intensive export-oriented industries as electrical appliances and electronics has risen considerably.

The additional comparative advantage that TNCs have in this situation is that they can draw on their transnational capacity to shift production from one country to another, diverting orders to benefit from reduced costs. They can shift the destination of the end product and can switch from production for the domestic market to sales for export markets, because as a result of the crisis the absorptive capacity of the region has diminished.

The Asian crisis demonstrates that attracting investment *per se* is not an indicator for sustainable development. The crisis led to much FPI being withdrawn, while FDI entered the same countries. This investment has, of course, not created new employment, but has integrated national corporations into TNCs with decision making abroad. As a result more profit made by these firms will flow back to the home countries of the TNCs, rather than remain within domestic economies. Such policies will not contribute to social development.

The crisis created unemployment, because the domestic and regional markets collapsed. Prices from food imported into the affected countries increased dramatically, and poverty has grown as a result. The Asian crisis shows the importance of sound investment policies for sustainable social development.

#### 9.4 Investment Treaties

The global expansion of TNCs has grown enormously in the last decade due to the world-wide liberalisation of investment. At present, investment treaties are at bilateral and/or regional levels. The number of bilateral treaties is expanding – from 1 360 at the end of 1996 to 1 513 in 1997, with the number of countries concluding investment treaties rising from 165 in 1996 to 169 in 1997. Increases continued in 1998.

The expansion of liberalisation of investment has created a situation in which liberalisation policy alone does not motivate the attraction of FDI, since there is increasingly an international climate conducive to FDI. This means that incentives, or rather determinants to attract investment, become increasingly important, particularly for countries that have few other comparative advantages:

“Competition between developing countries of this kind is, of course, wasteful.

Raising the average level of incentives mainly benefits MNCs, while raising marginal incentives may only benefit one developing country at the expense of another.”<sup>261</sup>

(original emphasis)

The lack of control on investment now means that those that benefit from liberalisation of investment are primarily TNCs. The incentives to attract them can quickly result in cut-throat, beggar-my-neighbour competition between already poor developing countries.<sup>262</sup>

#### 9.4.1 *The multilateral agreement on investment*

The primary motivation behind the multilateral agreement on investment (MAI), which included all investment – FDI and FPI – was the recognition of the importance of international investment and the lack of a single instrument:

“Investment, like trade, is an essential agent of economic growth, employment, sustainable development and rising living standards. Yet the multilateral system lacks a comprehensive and coherent framework of” rules of the game” for investment.”<sup>263</sup>

The, now moribund, proposals for the MAI was a project of the OECD – after it had been impossible to place it in the newly established WTO. The OECD began negotiations for an MAI in 1995. Once the draft agreement, negotiated by a number of technical groups, became public, it was subject to a barrage of criticism. First of all, the process of the negotiations had excluded developing countries. The process also excluded civil society and largely by-passed national parliaments. The MAI proposal further placed economic considerations above political, social and environmental considerations and its acceptance would have contravened much national legislation. It would certainly have curbed a government role in investment decisions and the direction of investment. Particularly worrying was the fact that the agreement would give companies/investors the power to bring complaints against governments when disputes arose.<sup>264</sup>

The negotiations were formally suspended after Prime Minister Jospin announced that France would no longer participate in the negotiations. This announcement followed the publication of the Lalumière report.<sup>265</sup> As a result negotiations could no longer continue in the OECD, since it operates by consensus. In the diagnostic section of the Lalumière report to the French government, particular attention is given to the civil society opposition. Whilst critical of the process and the organisation of the negotiations, the report focuses primarily on the architecture of the agreement itself, in which the governments are made subordinate to foreign investors by law:

“By definition, every international agreement limits the sovereignty of its signatories. It subjects them to obligations that hamper their freedom to act. However, economic obligations have so far always been expressed in relative terms: governments undertake not to discriminate between national and foreign products, investments and even persons within their territory. Within this framework, countries are free to determine and

implement their own economic and social policies. This has been the basic principle behind liberalisation or economic exchanges and trade for the last fifty years. The MAI goes further. For the first time, a universal multilateral agreement imposes absolute obligations on the participating countries.<sup>266</sup> (original emphasis)

Whilst taken singly, the report argues, the innovations may seem technically justified but:

“Their combination is explosive. It creates a feeling of unequal rights, both between governments and businesses and between national and foreign investors (since only the latter are entitled to the guarantees offered under the agreement).<sup>267</sup>

The EU is now consistently – and with apparent success – pushing for the inclusion of investment on the agenda for the forthcoming WTO Millennium Round of multilateral negotiations. Others, including a large number of developing countries, such as the ACP, consider that the most appropriate international forum for such a negotiation on investment would be in UNCTAD. ASEAN is one of the principal opponents of multilateral negotiations on investment. They take the position that no decision can be taken on negotiating a MAI unless it is linked to competition policy, and until such time that the WTO working groups on competition policy and investment have completed their respective work and studies.<sup>268</sup>

## 9.5 The ASEM Investment Promotion Action Plan

The ASEM investment Promotion Action Plan presented and endorsed by the ASEM II Summit, hailed in its foreword as “*truly a flagship initiative of Asia-Europe economic co-operation*” is in reality a very limited agreement. It does not address any of the questions raised above, or deal with any of the problems associated with investment policies. The primary purpose of the plan is to create opportunities for business people to meet. The objective is to:

“[G]enerate greater two-way investment flows between Asia and Europe through enhancing the investment climate between and within Asia and Europe.”<sup>269</sup>

Activities under IPAP are grouped under two pillars:

- investment promotion; and
- investment policies and regulations.

Activities within the first pillar are designed to facilitate and enhance investment and business. Under this pillar the business sector is regarded as the major player, with

government playing a supporting role. Three principal activities are outlined under this pillar: ASEM virtual information exchange, the ASEM Decision-Makers Roundtable for chief executive officers and top-level executives of large and medium-sized Asian and European companies, and the ASEM Business-to-Business Exchange programme between managers from Asia and Europe.

The second pillar is to conduct a high level dialogue on investment issues. It is recognised in the document that there are clear differences of priority accorded to the regulatory aspect of IPAP:

“European opinions, expressed by both governments and business, stress the importance of a sound, coherent and transparent legal framework for FDI, based essentially on non-discrimination (national treatment and most favoured nation treatment) and state-of-the-art investment protection, as found in many bilateral investment protection treaties recently concluded. However, many (but not all) Asian ASEM partners, and a relatively high proportion of Asian companies, especially from the ASEAN member states, consider an extended discussion on the key regulatory principles as ‘irrelevant’ or ‘of low interest’.”<sup>270</sup>

However, the document stresses that, even in Asia, the majority of companies judged regulatory principles to be ‘important’ or ‘somewhat important’. The distinction is between capital exporting companies, which require or prefer a sound regulatory framework, and capital importing companies, which do not see this as a priority. It is stressed in the document that the approach is one of:

‘mutually beneficial dialogue and consultation, and not on negotiations within the ASEM forum’.<sup>270</sup>

#### *9.5.1 A social development perspective of IPAP*

ASEM foreign Ministers recognised the importance of SMEs in their meeting in March 1999 but this has not been translated into concrete plans. IPAP identified the lack of venture or seed capital – especially to support market entry activities of SMEs, as a problem, but there is no suggestion in the IPAP as to how SMEs are to benefit from investment promotion.

IPAP does not target SMEs, nor micro-enterprises, often operating within the informal sector and the backbone of survival strategies for people living in poverty. Without specific intervention, SMEs and micro-enterprises will remain marginal. Globalisation and increased competition resulting from liberalisation will make these enterprises even more vulnerable. It will encourage the transfer of environmentally sensitive activities by offering the least costly environmental safeguards and restrictions. It will encourage sub-contracting to domestic micro enterprises and SMEs to take advantage of poor labour standards and illegal conditions, in-

cluding tax avoidance. In order to ensure that investment promotion is productive and sustainable, and as a part of competition policies, the interests of SMEs must be part of the agenda of IPAP.

Apart from the lack of focus on SMEs and micro-enterprise, the crucial problem with IPAP is that it ignores the current problems in the financial markets. While the proportions of the crises as they emerge are gigantic, IPAP remains with no other focus than facilitating contacts between larger businesses of the EU and Asia. It addresses neither investment promotion in the narrow sense, nor does it focus on broader questions related to, and problems associated with, investment flows between developed and developing countries. IPAP's focus is to indiscriminately increase the investment flows from Europe into South-east Asia. As part of a development oriented EU policy, or as an instrument within the context of serious financial problems caused by the uncontrolled movements of capital – particularly when recognising the potential role that the EU could play in improving the international financial architecture, IPAP can hardly be accorded 'flagship status'. Quite the contrary, it is totally irrelevant.

## 9.6 A development perspective on investment promotion

The emerging question is how EU policies relating to investment can be made more coherent with its development objectives. If it is assumed that FDI is necessary for development, one needs to consider the question as to how productive FDI can be attracted, while the inflow of FPI is avoided. In the past national policy frameworks and bilateral or regional treaties facilitating the liberalisation of investment have promoted FDI. These policies are by themselves increasingly insufficient to motivate capital to enter a country. Additional incentives are required in order to attract capital.

Incentives to attract FDI include measures such as the abolition of labour and environmental standards, the banning of trade unions, the decrease or abandonment of minimum wages. These are measures, that are often taken already in the EPZs, and increasingly in developing countries in general in the race to attract FDI. They generally have a negative impact on the development capacity of the domestic country because, even though the FDI may generate employment, the increased and uncontrolled competition negatively affects wages and has a dampening effect on the development of salaries in other sectors. Therefore the newly generated labour does not create additional income or purchasing power in the host country.

Incentives also include tax redemption measures, as well as guarantees by governments to ensure profit margins for incoming TNCs. These measures have negative consequences for the domestic country because little, if any, of the profit that may be generated by the companies will flow into the economy of the host country, while in increasingly many instances, the guarantees given by hosts for the profits of TNCs are paid for by domestic tax payers.

Finally the governments are increasingly giving away political and military control to TNCs as a means of attracting FDI. The legal agreements between the consortium of oil companies planning the Chad-Cameroon pipeline with the Cameroon government are a point in case. This agreement takes priority over the constitution, and the consortium has full powers to use military means to protect its assets in the country. Meanwhile the security of the people resident in the host country, Cameroon, is not guaranteed and the TNC has no obligation to take responsibility for their well-being.<sup>271</sup>

As a means to attract FDI this scenario seems to defeat its purpose of creating development. In the race for minimum standards the difference between FDI and FPI diminishes, because any investment – including that which is productive, can move around relatively freely and easily, searching for places that will offer even more attractive benefits for the companies. To control the volatility of speculative capital a new architecture of the international financial system is needed. For instance the Tobin Tax, or a foreign exchange transaction tax, could help control the movement of speculative capital. Introduction of such a tax would also defend exchange rates from speculative attacks, manage transitions between exchange rate regimes and finance international public projects. Often argued to be impracticable it is now seen as a perfectly feasible instrument.<sup>272</sup> The proposed World Financial Authority could be a helpful instrument if it would enable national governments to impose restrictions on external capital movements, for instance through taxation of cross-border financial flows.<sup>273</sup>

While instruments to control the free movement of capital flows are an important factor to create investment with a longer-term perspective, a sustainable and social development approach additionally requires that this is not entirely dependent upon export-oriented growth and uncontrolled liberalisation. Interaction with the global economy will only be generating long-term development for the South if the exchange is based on equal levels of economic development. Before fully entering into the global market, the national economic capacity needs to be strengthened. This approach, also termed the “*It’s the development, stupid!*” – school,<sup>274</sup> stresses that:

“[t]he main problem (...) lies not in the volatility of speculative capital, but in the way that the export sector and foreign capital have been institutionalized as the engines of

these economies. The problem is the indiscriminate nature of the developing economies into the global economy and the over-reliance on foreign investment, whether direct investment or portfolio investment, for development.<sup>39275</sup>

The priority for investment policies conducive to development is to build competitive productive capacity within the domestic country. Regional integration can be developed as a useful strategy to expand domestic-market driven growth, through regional import substitution and protected market-integration. With a primary focus on the region's producers serving the region's consumer market, economic growth is financed from domestic savings and investment. In this context cancellation of international debts remains a key issue for enabling economic growth based on increasing domestic capacity.

## 9.7 Conclusions

In the Maastricht Treaty (1992) the EU was given competence in development co-operation. It defined the objectives for development policies as:

- the campaign against poverty;
- social and sustainable development; and
- the integration into the world economy.

These objectives do not represent a menu of choices but are an interdependent package. Moreover, other EU policies that affect developing countries should take into account the development objectives.

The profile of investment flows shows the increasing importance of FDI to developing countries. This is a rather one-way flow even though FDI from developing countries to the three economic powers is also increasing. While increasing, this flow is still marginal. This is illustrated by the fact that only two corporations based in the South feature in the largest hundred TNCs in terms of foreign assets. The financial crises have actually exacerbated this inequality, because it has allowed TNCs from the three major economic blocks to acquire companies affected by these crises and, sometimes, driven into bankruptcy.

A control on foreign exchange transactions is badly needed, because it is precisely the volatility of speculative capital that endangers the macro-economic framework of developing countries. Policies to reduce the uncontrolled movement of capital flows are essential for generating investments with long-term objectives. An international financial instrument, such as the Tobin tax, would engender an environment more conducive to social sustainable development. The

implementation of such an instrument is perfectly feasible. A World Financial Authority could also be a helpful instrument if it would enable national governments to impose restrictions on external capital movements, for instance through taxation of cross-border financial flows.

Investment Promotion is one of the two key areas developed in the context of the Europe – Asia Meeting (ASEM). ASEM was established during a summit in Bangkok in 1996 and has the objective to foster peace and stability, and to create conditions conducive to economic and social development. It was established as a counterbalancing force to APEC, formed in 1989, and responded to a desire from a number of ASEAN countries to guard their economic and political independence. The European Union was first and foremost interested in enhancing its own political and economic profile in the Asian countries.

The Investment Promotion Action Plan (IPAP) was hailed as '*a truly flagship initiative of Asia-Europe economic co-operation*'. It was approved at the second ASEM summit held in London in April 1998 after the Asian crisis. The timing would suggest that the policies and actions would respond to the financial crisis that hit the ASEM developing countries. A closer examination of the plan reveals that it is irrelevant to any of the major questions emerging from the crisis and its aftermath.

For European policies on investment to be coherent with development objectives there needs to be a total reversal of current thinking. The implicit acquiescence with the international order – seen from the perspective of the International Financial Institutions, which have created and exacerbated the current problems for developing countries, is simply no longer acceptable. The EU should take its responsibility as a global player to allow developing countries to strengthen their domestic and regional economic base before interacting fully with the global economy. The EU must foster macro-economic frameworks that accepts developing countries' protection of their national productive capacity against indiscriminate foreign penetration.