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Foreign Direct Investment from Emerging Markets: The Challenges Ahead

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The Challenges Ahead

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Chapter 1

Foreign Direct Investment by Emerging Market Multinational Enterprises, the Impact of the Financial Crisis and Recession, and Challenges Ahead

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Introduction

The global market for foreign direct investment (FDI) has undergone significant changes in recent years, with the increasingly important role played by emerging market multinational enterprises (MNEs) being one of the most important among them. While outward FDI (OFDI) from these countries, in itself, is not new, the magnitude that this development has achieved has raised a host of issues, which we will examine in this volume. This opening chapter presents the factual background of this phenomenon, the impact of the financial crisis and recession on FDI flows, and the issues and challenges related to emerging markets' high FDI flows.

1.1 The Rise of Emerging Market Foreign Direct Investment in Context

1.1.1 The Rise of Global OFDI Flows

The rise of global OFDI over the past three decades has been remarkable. Since 1980–1985, when global OFDI flows averaged roughly US$50 billion per year, OFDI flows have grown by a factor of forty, to surpass US$2.1 trillion in 2007. In 2008, due to the financial crisis and the global economic downturn, global OFDI flows fell by roughly 10% to US$1.9 trillion (figure 1.1 and table 1.1).

Direct investment flows from developed countries'[1] multinational enterprises (defined as firms controlling assets abroad) have grown by roughly 40% on average from 2003 to 2007 (figure 1.1), supported by high economic growth in key host economies and strong corporate performance. In 2008, due to the financial crisis and the global economic downturn, OFDI flows

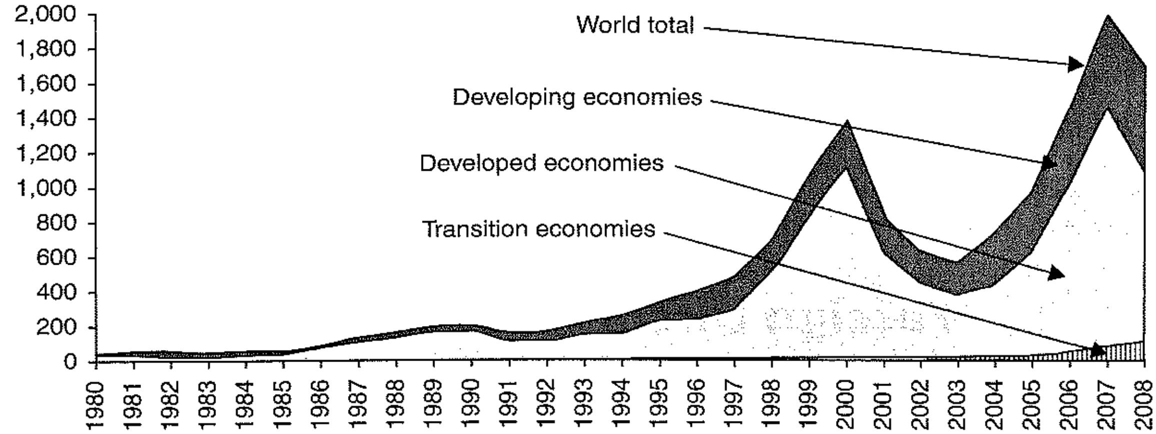

Figure 1.1 FDI outflows, globally and by group of economies, 1980–2008 (US$ billions)
Source: UNCTAD, WIR (2009h).

Table 1.1 FDI outflows and cross-border M&A, by region and major economy, 2007–2008 (US$ billions)

	FDI outflows			Cross-border M&A purchases[a]		
Region/economy	2007	2008	% change	2007	2008	% change
World	**2,146.5**	**1,857.7**	**–13.5%**	**1,031.1**	**673.2**	**–34.7%**
Developed economies	**1,809.5**	**1,506.5**	**–16.7%**	**842.0**	**598.0**	**–29.0%**
Europe	1,270.5	944.5	–25.7%	569.4	333.5	–41.4%
United States	378.4	311.8	–17.6%	179.8	72.3	–59.8%
Japan	73.5	128.0	74.1%	30.4	54.1	78.0%
Developing economies	**285.5**	**292.7**	**2.5%**	**139.7**	**99.8**	**–28.5%**
Africa	10.6	9.3	–12.3%	9.9	8.2	–17.1%
Latin America and the Caribbean	51.7	63.2	22.2%	38.5	2.6	–93.3%
Asia and Oceania	223.1	220.2	–1.3%	91.3	89.0	–2.5%
West Asia	48.3	33.7	–30.3%	37.1	20.5	–44.7%
South, East, and Southeast Asia	174.7	186.5	6.7%	54.2	68.8	26.9%
Transition economies	**51.5**	**58.5**	**13.6%**	**21.7**	**20.6**	**–5.0%**

Source: UNCTAD, WIR (2009g).
[a]Net purchases undertaken by region/economy of the ultimate acquiring company.

from developed countries fell by almost 17% from US$1.8 trillion in 2007 to US$1.5 trillion. Globally, the number of MNEs rose to more than 80,000 in 2007, with more than 800,000 foreign affiliates spread all over the world.

OFDI flows from developed economies, in particular from the European Union (EU) and the United States, represented roughly 84% of total OFDI flows in 2007 and 81% in 2008 (versus 90% between 1995 and 2000). Such investment from developing countries amounted to roughly 12%–13% of total OFDI flows (10%–11% between 1995 and 2000), dominated by Asian MNEs. OFDI flows from transition economies grew strongly and represented 2.4% of total OFDI flows in 2007 and 3.1% in 2008, up from 0.3% on average between 1995 and 2000 (UNCTAD 2008, 2). Roughly two-thirds of global OFDI flows in 2007 were directed toward developed countries, about one-quarter to developing countries (in particular to Asia), and roughly 5% to transition economies.

The global environment for OFDI is changing rapidly. Various "traditional" factors, among them the continuing liberalization of FDI regimes worldwide, competition among firms from all parts of the world, and technological and logistical advancements, influence and support global OFDI flows from both developed and emerging market MNEs. In the future, however, several "nontraditional" factors might additionally shape the FDI landscape, as Jeffrey D. Sachs argues (chapter 2). Sachs looks at the changing FDI landscape from a macroperspective and discusses natural resource constraints and the challenge of sustainable economic growth. The inelastic supply of critical resources—food, oil, metals—has an immediate impact on commodities prices; climate shocks damage the world's food supplies. The scarcity of water and arable land has already led to an increased FDI into the agricultural sector of several developing and least developed countries (see Cotula 2009). Sachs argues that these patterns will become more frequent in the future and will influence the economic determinants of FDI. In order to reconcile the huge global potential for dynamic economic growth with the limited global resource base, new technologies, new forms of cooperation, and new kinds of global arrangements are required.

The dramatic changes in the FDI landscape in the past four decades are the subject of discussion in Yair Aharoni's contribution to this volume (chapter 3). The sectoral composition of global FDI flows has undergone considerable change: while FDI into services made up roughly 25% of global FDI stocks in the early 1970s, services now account for almost two-thirds of global FDI flows. In addition, FDI into the infrastructure sector (e.g., electricity, telecommunication) has been rising strongly. The strong competitive pressures generated by the globalization process force firms to internationalize increasingly early, sometimes already at the moment they are established ("born global"), thereby requiring a revision of the traditional view that firms internationalize gradually and in a sequence that begins with exports. In light of these changes, Aharoni questions whether some of the existing theories that have explained the internationalization process of MNEs are now obsolete.

The rise of global OFDI flows came to a temporary halt in 2008 and 2009, when the financial crisis and the global economic downturn had a negative impact on global FDI flows, in particular on OFDI flows from developed countries. Despite the global downturn, OFDI flows from emerging markets s rose in 2008, albeit marginally (table 1.1), but before declining in 2009 . Given the financial crisis and recession's effects on global FDI flows, section 1.2 of this chapter examines their impact on the FDI flows of both emerging markets and developed countries.

1.1.2 The Rise of OFDI Flows from Emerging Markets

OFDI flows from emerging market MNEs (that is, firms from both developing countries and transition economies) have shown particularly dynamic growth rates of roughly 82% on average since 2003, to reach approximately US$351 billion in 2008 (US$293 billion from developing countries and US$58 billion from transition economies). This growth has been driven partly by strong OFDI growth from transition economies, in particular from the Russian Federation (table 1.2).

The regional distribution of emerging market OFDI has undergone considerable change over the past three decades: Asia has overtaken Latin American and the Caribbean to become the dominant region for MNEs engaged in OFDI. While emerging market MNEs have become important investors in many other developing countries, they also increasingly invest in developed countries. Most of this investment is in services, including those that support trade. Natural resources firms, too, are important outward investors.

The overall number of MNEs from developing countries has been rising in line with total OFDI flows: in 2008, UNCTAD counted more than 21,000 MNEs from developing countries and nearly 2,000 from transition economies. This number reflects not only the growing ownership advantages of these firms but also the pressure on firms everywhere to acquire a portfolio of locational assets as a source of international competitiveness. Of the 21,000 MNEs from developing countries, approximately 3,500 were from China, about 1,000 from Russia, 815 from India, and 220 from Brazil (UNCTAD 2009h; Panibratov and Kalotay, forthcoming).[2]

The relatively small number of BRIC[3] country MNEs is also reflected in the list of the twenty largest nonfinancial MNEs from emerging markets by foreign assets for the year 2006 (table 1.3). Only six are from BRIC countries: two from China, two from Brazil, and two from Russia. Out of the "Top 100" nonfinancial MNEs from developing countries, nine hail from China, three from Brazil, and two from India.

A recent feature of OFDI from emerging markets is the involvement of sovereign wealth funds (SWFs). Several Asian, Middle Eastern, and oil-rich

Table 1.2 FDI outflows, by home region and BRIC economy, 1980–2008 (US$ billions)

Region	1980	1990	2000	2001	2002	2003	2004	2005	2006	2007	2008
World	51.5	239.1	1,231.6	751.3	537.4	562.8	920.2	880.8	1,396.9	2,146.5	1,857.7
Developed economies	48.4	227.2	1,093.7	665.7	483.2	507.0	786.0	748.9	1,157.9	1,809.5	1,506.5
Developing economies	3.2	11.9	134.8	82.9	49.6	45.0	120.0	117.6	215.3	285.5	292.7
Brazil	0.4	0.6	2.3	−2.3	2.5	0.2	9.8	2.5	28.2	7.1	20.5
China	–	0.8	0.9	6.9	2.5	2.9	5.5	12.3	21.2	22.5	51.2
India	0.0	0.0	0.5	1.4	1.7	1.9	2.2	3.0	14.3	17.3	17.7
Transition economies	–	0.0	3.2	2.7	4.6	10.7	14.1	14.3	23.7	51.5	58.5
Russian Federation	–	–	3.2	2.5	3.5	9.7	13.8	12.8	23.2	45.9	52.4

Source: UNCTAD, WIR (2009g).

Table 1.3 Top twenty nonfinancial MNEs from emerging markets, ranked by foreign assets, 2006 (US$ millions)

			Assets		Employment		Number of affiliates	
Corporation	Home economy	Industry	Foreign	Total	Foreign	Total	Foreign	Total
Hutchison Whampoa Limited	Hong Kong, China	Diversified	70,679	87,146	182,149	220,000	115	125
Petronas-Petroliam Nasional	Malaysia	Petroleum	30,668	85,201	3,965	33,439	4	78
Samsung Electronics Co.	Republic of Korea	Electrical and electronic equipment	27,011	87,111	29,472	85,813	78	87
Cemex S.A.	Mexico	Nonmetallic mineral products	24,411	29,749	39,505	54,635	493	519
Hyundai Motor Co.	Republic of Korea	Motor vehicles	19,581	76,064	5,093	54,711	19	28
Lukoil	Russia	Oil/gas	18,921	48,237	22,000	148,000	182	...
Singtel Ltd.	Singapore	Telecommunications	18,678	21,288	8,606	19,000	103	108
CITIC Group	China	Diversified	17,623	117,355	18,305	107,340	12	112
Formosa Plastic Group	Taiwan Province of China	Chemicals	16,754	75,760	671,229	89,736	11	12
Jardine Matheson Holdings Ltd.	Hong Kong, China	Diversified	16,704	20,378	58,203	110,125	108	126
LG Corp.	Republic of Korea	Electrical and electronic equipment	15,016	53,915	36,053	7,000	3	12
Vale	Brazil	Mining and quarrying	14,974	60,954	3,982	52,646	17	52
Gazprom	Russia	Oil/gas	10,572	204,228	5,470	432,000	105	...
Petrobas	Brazil	Petroleum	10,454	98,680	7,414	62,266	7	74
China Ocean Shipping (Group) Co.	China	Transport and storage	10,397	18,711	4,432	69,549	245	947
America Movil	Mexico	Telecommunications	8,701	29,473	27,506	39,876	16	33
Petroleos De Venezuela	Venezuela	Petroleum	8,534	60,305	5,373	49,180	30	65
Mobile Telecommunications Co.	Kuwait	Telecommunications	7,968	12,027	975	12,700	37	40
Capitaland Ltd.	Singapore	Real estate	7,781	13,463	16,261	382,000	25	233
Hon Hai Precision Industries	Taiwan Province of China	Electrical and electronic equipment	7,606	19,223	322,372	382,000	82	94

Source: The authors, based on UNCTAD, WIR (2008), 223, and SKOLKOVO-CPII 2008 ranking of Russian multinational enterprises, available at http://www.vcc.columbia.edu/projects/documents/SKOLKOVO-CPIIPressReleaseEnglish_000.

economies, whose foreign currency reserves have risen as a result of high commodity prices and current account surpluses, have pooled part of these reserves in SWFs. The volume of funds under SWF management is estimated to be around US$5 trillion globally (end-2008), of which US$4 trillion are controlled by emerging markets (UNCTAD 2008, 20).

Although FDI via SWFs was negligible in comparison to FDI by other types of investors[4] or the role of state-owned enterprises (SOE) in the OFDI activities of some emerging markets (e.g., China), the negative political reaction to FDI by SWFs—and, for that matter, by SOEs—was considerable.[5] The fear of foreign control over critical domestic infrastructure and strategic industries, and the implications for national security, were at the forefront of a lively discussion. It intensified in 2007 and 2008, when SWFs from Southeast Asia and the Gulf Region bought large portfolio stakes in ailing flagship U.S. and European financial firms such as Morgan Stanley, Merrill Lynch, UBS, and Citigroup, or into U.S. private equity funds such as Blackstone, Carlyle, and Apollo (UNCTAD 2008, 24).

Growing OFDI from emerging market firms, and from BRIC countries' MNEs in particular (section 1.1.3), has given rise to the question of whether these "new kids on the block" are fundamentally different from their developed countries' peers. Part I of this volume ("The Lay of the Land") is devoted to a discussion of the theoretical foundations of emerging market OFDI.

Rob van Tulder (chapter 4) opens the discussion and analyzes emerging market OFDI based on the existing theoretical framework. He finds that the country- and firm-specific advantages of emerging markets do not require the development of a completely new theory, but can be explained by amending existing frameworks (such as the eclectic theory by John H. Dunning and the related concept of the investment development path). Van Tulder even discourages the quest to find an explanation for all emerging market MNEs: given the immense differences in this group, he regards such an endeavor as ill-advised. However, a separate theoretical approach can—and perhaps must—be adopted to explain MNEs from the BRIC countries. Van Tulder identifies and discusses four elements of renewal: the relationship with the *home country government*, the importance of *market power* in the home market, a reappraisal of the impact of *economic size* and its relationship with political power, and a reappraisal of the *general theory of the firm*. He finally refines the *investment development path* with a mesoeconomic layer of analysis in order to explain better OFDI from the BRIC countries.

Alan M. Rugman (chapter 5) takes the discussion a step further and analyzes the firm-specific advantages and disadvantages of emerging market MNEs. In line with van Tulder, Rugman does not support a major change in the existing theoretical framework for FDI. Most country- and firm-specific advantages of, for instance, Chinese or Indian MNEs, can be explained by economies of scale, fueled by the abundance of cheap labor, natural resources, and possibly cheap money. Art Durnev (chapter 6) critically reflects on Rugman's analysis and finds distinct features in some emerging market countries, such as the lack of "soft" financial infrastructure (e.g., credit rating agencies, managerial skills), the nonexistence of appropriate investor protection mechanisms or a lack of transparency (e.g., opaque regulatory and business environment).

1.1.3 OFDI Flows from the BRIC Country Group

The BRIC country group—Brazil, the Russian Federation, India, and China—was one of the driving forces behind the rise of emerging market OFDI flows. With OFDI flows of roughly US$141.7 billion in 2008, this group accounted for approximately 40% of total OFDI flows from emerging markets (table 1.2 above).

Looking at the development of OFDI flows from the BRIC countries since 2000, it is noticeable that Russian MNEs increased their OFDI markedly Russian OFDI stock reached a value of US$255 billion by end-2007, followed by Brazil with roughly US$130 billion, China with approximately US$96 billion, and India with roughly US$30 billion. Part II of this volume is devoted to an analysis of emerging market OFDI from a country perspective, with a particular focus on the BRIC country group ("Gaining Ground: The Expansion of Emerging Market Multinationals").

Brazilian MNEs engaged in OFDI activities in the amount of roughly US$7 billion in 2007, down from the high level reached in 2006 (US$28 billion); the decline was mainly due to one large acquisition undertaken in 2006 (see Lima and de Barros 2009).[6] Preliminary data for 2008 shows an OFDI volume of US$21 billion. Overall, however, OFDI has been rising appreciably in recent years in line with the internationalization plans of Brazilian firms striving for leadership mainly in oil and gas, metal, mining, cement, steel, and food and beverages industries, and helped by the appreciation of the Real (UNCTAD 2008, 60). Paulo Resende et al. (chapter 7) provide a closer look at the transnationalization process of Brazilian MNEs and argue that foreign barriers encouraged OFDI in some sectors (e.g., Brazilian steel companies trying to circumvent target country quota systems). Based on surveys, the authors demonstrate which factors mainly drive the internationalization process of Brazilian MNEs from the executive managements' point of view: better market access, the potential to increase sales internationally, as well as the utilization of economies of scale.

Russian MNEs continued to intensify their OFDI activities, which amounted to US$46 billion in 2007, thereby surpassing the combined OFDI flows from the other three BRIC countries. Data for 2008 shows an OFDI volume of US$52 billion. Russian firms have mainly engaged in resource-seeking FDI projects in pursuit of raw materials and access to strategic commodities. However, they have suffered from a poor image abroad due to the perceived commingling of public and commercial interests. Kalman Kalotay (chapter 8) provides an overview of the main drivers and salient features of Russian OFDI, including its geographical patterns, a panorama of the largest Russian MNEs, and a discussion on the role of government policies (see Panibratov and Kalotay, forthcoming). In his discussion of salient features, Kalotay underlines that Russia, despite its status as a lower-middle-income country, has become a net capital exporter. In fact, several Russian firms, such as Gazprom, Lukoil, Norilsk Nickel, and Severstal, have attained global status. Although Russian MNEs are a heterogeneous group, they do share several commonalities, such as their "leapfrogging" onto the global stage (leveraged by natural resources incomes), their strong link with the natural resources sector, and the strong and growing role of the Russian government.

OFDI by *Indian* MNEs amounted to roughly US$17 billion in 2007, and their OFDI stock represents a value of US$30 billion, approximately 3% of India's gross domestic product (GDP) (see, for example, Pradhan 2009). Data for 2008 show an OFDI volume of US$18 billion. Both OFDI stock and flows are small in comparison with India's BRIC peers, in particular when compared with China and Russia, partly reflecting India's political hesitance to allow OFDI on a larger scale. However, several prominent foreign acquisitions by such Indian firms as the Tata Group, Infosys, and Wipro have brought Indian MNEs into the academic and political limelight. Andreas Nölke and Heather Taylor (chapter 9) analyze OFDI from India in a broader context, distill salient features of this investment, and present the driving forces and enabling conditions behind them. Among the most striking features of Indian MNEs is their preference for mergers and acquisitions (M&As) in the triad region (United States, Western Europe, Japan/Australia). In addition, Indian MNEs have focused their acquisitions on high-tech, knowledge-intensive industries such as pharmaceuticals and information technology services. The authors discuss the liberalization of the Indian OFDI framework in the early 1990s and the role it has played in facilitating Indian OFDI, in particular from industry players that enjoyed regulatory protection and supportive industrial and technological policies.

Chinese OFDI flows have been rising strongly and reached US$23 billion in 2007, thereby adding to the Chinese OFDI stock of US$96 billion. In 2008, they more than doubled to US$51 billion. Driven by strong demand for natural resources, in particular oil, China became an increasingly important source of investment for many resource-rich countries in Africa, Central Asia, and Latin America. In addition, Chinese banks have started to acquire stakes in the financial sector of developed countries.[7] Huaichuan Rui et al. (chapter 10) provide an insight into the motivation, characteristics, and issues of selected Chinese OFDI transactions (acquisition projects of Nanjing Automobile, Lenovo, and Huawei Technology). The authors directly compare these transactions with OFDI projects of Indian competitors (automaker Maruti, IT companies Wipro and Infosys) of these Chinese MNEs in order to distill the key drivers and challenges of these particular acquisitions, based on interviews conducted with the executive management of these firms. Based on the findings concerning the Chinese firms, and the fact that all three had previously formed joint ventures with Western partner firms before engaging in these OFDI transactions, the authors question the current wisdom that allows both partners access to existing knowledge. Also, Chinese firms experience increasingly fierce competition in their "backyard," pushing these firms to internationalize rapidly.

An interesting comparison to the experience of BRIC countries' MNEs is provided in Andreja Jaklič's and Marjan Svetličič's analysis of key features, drivers, and challenges of MNEs from Slovenia (chapter 11), a country that joined the group of developed countries only recently. The authors underline the importance of human resources and managements skills for the success of Slovenia's MNEs, a lack of which can represent a major OFDI constraint. Concerning OFDI barriers, the authors identify various home country as well as internal firm barriers. The late liberalization process and the lack of government support are among the most challenging external barriers. The key internal barriers are related to the "human factor": a lack of management experience and internationalization knowledge. In addition, fast-paced globalization does not allow for an organic approach to deal with these deficiencies.

The BRIC country group shares some common patterns with regard to their OFDI activities. Among the commonalities is the preferred OFDI market entry mode: the country-specific analyses in chapters 7–10 illustrate that all BRIC countries have shown a preference for M&As versus greenfield investments.

However, with regard to a number of other salient features, OFDI from the BRIC countries shows a variety of specific choices, also in comparison to other emerging markets. To begin with, only China and Russia have a substantial SOE involvement in their OFDI. In Russia, the role of the government has been large and growing since 1999; SOEs now account for 26% of total foreign assets held. In China, SOEs account for 80%–90% of the country's OFDI (Cheng and Ma 2007). SOEs also dominate cross-border M&As: out of the fourteen largest foreign investments of Chinese financial institutions, nine were undertaken by state-owned entities. Some studies argue that 75% of all outbound M&A activities from Chinese firms have involved government controlled entities (Deutsche Bank Research 2009b, 34), which seems consistent with the high percentage of state ownership in both financial and nonfinancial corporations.

Moreover, whereas emerging market OFDI has typically followed a South-South investment pattern, Brazil, India, and recently Russia have shown a preference to acquire assets in developed countries, in particular in the United States and Western Europe. The notable exception is China: a majority of the country's OFDI has been directed toward other developing countries. However, the recent rise of Chinese direct investments into developed countries might indicate a change in its previous investment behavior.

No uniform pattern emerges with regard to the sectoral distribution of BRIC country OFDI. Brazil and the Russian Federation have shown a preference for the natural resources sector; China and India have mainly acquired foreign assets in the services sector; and Indian firms target knowledge- and technology-intensive industries, such as pharmaceuticals and automobile and automobile parts.

On the policy side, China's and India's OFDI is supported by the domestic policy framework, whereas no such framework exists yet in Brazil and Russia. Both China and India have adopted "go global" policies at the turn of the century, with noticeable impact on the outward investment strategies of domestic firms. This contrasts sharply with the fact that all four countries have a sophisticated regulatory regime governing inward FDI (IFDI). China's OFDI framework is the most sophisticated among the BRIC countries. Qiuzhi Xue and Bingjie Han (chapter 15) describe its evolution in some detail, from the early 1980s to the current "Going Global" policy framework that explicitly fosters Chinese OFDI. The authors also explain the complex interactions between the main regulatory authorities involved (e.g., the State Council, the Ministry of Commerce, and the State Administration of Foreign Exchange) and thus provide an insight into the approval mechanisms for OFDI transactions in practice.

From an international perspective, the volume of OFDI stock and flows from the BRIC countries remains modest: the BRIC "market share" in global OFDI stock was a mere 3% (US$510 billion) in 2007, and 5% with regard to OFDI flows (US$90 billion)—far below their market share in terms of GDP (Deutsche Bank Research 2009a, 1). Their share of emerging market OFDI total (US$2 trillion) stock was 16% at end-2007, and 15% with regard to total (U$304 billion) OFDI flows.

The catch-up potential for OFDI from the BRIC countries can be gleaned when comparing the OFDI stock to GDP ratios. Whereas developed countries show (on average) an OFDI stock of approximately one-third of GDP, Russia's OFDI stock amounts to roughly 20% of its GDP and Brazil's stock represents 10% of GDP. China's OFDI stock as a percentage of GDP has been growing from 2.5% in 2005 to 3% in 2007. India's OFDI stock grew from a mere 1.2% in 2005 to 2.6% in 2007. China and India thus show the biggest gap, but also catch-up potential, within the BRIC country group.

Despite the negative impact of the current financial crisis and recession on global OFDI flows (see the following section), OFDI flows from emerging markets, including the BRIC countries, are likely to resume their strong growth in the future.

1.2 The Impact of the Financial Crisis and Recession on FDI from Emerging Markets

What is the impact of the 2008–2009 financial meltdown and recession likely to be on FDI outflows from emerging markets? Given the magnitude of the crisis and the impact it is having on worldwide FDI flows (Fujita 2009; Sauvant 2008; UNCTAD 2009a), this issue deserves special attention, as the crisis will invariably affect OFDI from emerging markets as well.

Naturally, the answer to this question has to be speculative, as we are still in the middle of this crisis, and it is not yet known how severe it will be in the end, how long it will last, and how widespread it will be. Any impact works through the three sets of the principal FDI determinants: the economic situation, the regulatory framework for FDI, and investment promotion (UNCTAD 1998).

The most important FDI determinants are the economic factors, once the regulatory framework is enabling for such investment. One of the most critical among these factors is economic growth, as economic growth—or lack of it—influences the demand side for investment and for the goods and services produced by foreign affiliates. In 2009, world output declined by 0.6% (International Monetary Fund 2010, 2). Declining demand discourages investment (domestic and foreign), including by MNEs from emerging markets.

The crisis—and especially the financial crisis with its associated credit crunch—also affects the ability of emerging market firms to invest abroad. Put differently, even if MNEs were not deterred by the deteriorating economic situation in foreign markets, the supply-side for FDI has deteriorated sharply. In particular, the capacity of firms to finance M&As and greenfield investments has declined. Among other reasons, this is the case because international finance is harder to come by due to the credit crunch—a serious bottleneck for firms (e.g., from India) that finance their foreign expansion largely through credits. Declining earnings, weakening balance sheets, and the need for deleveraging accentuate this difficulty. Furthermore, the collapse of the commodity boom empties the coffers of some of the largest emerging market MNEs and hence restricts their ability to expand abroad (although there are some signs of recovery). In fact, a number of emerging market MNEs already had to divest themselves of foreign affiliates or repatriate a larger share of their foreign earnings in order to shore up their balance sheets (see Kalotay 2009; Mortimore and Razo 2009; *PiB* 2009; Pradhan 2009; UNCTAD 2009a).[8] Even sovereign wealth funds have curtailed their investments abroad: because earlier investments performed very poorly,[9] the value of their portfolios declined, the growth of their resources slowed down considerably, suspicion in developed countries regarding direct investments made by them rose,[10] and they need to shore up domestic firms and the domestic economy (see, for example, Setser and Ziemba 2009).

Not all emerging market MNEs, however, will be hamstrung by the current crisis. SOEs in countries with high foreign currency reserves, in particular, remain in a position to expand abroad, the regulatory environments of host countries permitting. Their ability to take a long-term horizon helps in this regard, and the fact that asset prices in a number of potential host counties are low or in distress encourages cross-border M&As (see, for example, Zhan and Ozawa 2001).[11] This factor could be quite important as SOEs account for a significant share of OFDI in a number of emerging markets. In the case of China, such enterprises were responsible for 83% of FDI outflows in 2005 and some 84% of the country's OFDI stock (see Cheng and Ma 2007, 10). Furthermore, future Chinese OFDI finds support in a stable currency value and the availability of domestic liquidity. The appreciation of the Renminbi vis-à-vis the dollar and euro facilitates Chinese acquisitions of dollar- and euro-denominated assets. Chinese domestic liquidity is partly fueled by a US$2 trillion large foreign reserves pool, of which some US$400 billion are under the management of several Chinese SWFs (IFSL Institute 2008).

The worsening economic situation and the unfavorable position in which many emerging market MNEs find themselves may be further complicated by a FDI regulatory framework that is becoming less welcoming worldwide, especially for state-controlled entities from emerging markets. Thus, the percentage of annual changes in FDI laws across the world that went in the direction of making the investment climate less welcoming for MNEs went from 6% during the period 1992–2002 to 12% from 2003–2004 and 21% from 2005–2007 (see UNCTAD 2008). In fact, the share of world FDI flows affected by countries making at least one unfavorable regulatory change during 2006–2007 was 40% (see Sauvant 2009, 239–40). A number of these unfavorable changes involve the increased screening of M&As by state-controlled entities from emerging markets (see Sauvant 2009; Fagan 2010; OECD 2009; UNCTAD 2009c).

In other words, the rise of FDI protectionism may make it more difficult for emerging market MNEs to expand their international production networks. A deepening crisis may well lead to more FDI protectionism[12] and, at least on the margins, discourage OFDI from emerging markets.

Still, the national FDI regulatory framework in virtually all countries remains overwhelmingly favorable. It is further enhanced by a dense network of bilateral investment treaties (BITs) (and double taxation treaties), whose main purpose is to protect foreign investors. By the end of 2008, 37% of the total number of BITs (2,676) had been signed between emerging markets (UNCTAD 2009e).

Moreover, it is quite possible that countries will strive to counteract the forces depressing FDI flows by increasing their investment promotion efforts, including, in particular, by seeking to retain the investments they have already secured. Investment promotion agencies of a number of developed countries, in particular, have already established offices in key emerging markets to attract direct investment from them. Such efforts can help to sustain OFDI flows from emerging markets, but their effectiveness is largely dependent on the nature of the much more powerful economic FDI determinants.

How will these various factors balance each other? Given the dominant importance of the economic FDI determinants, OFDI from emerging markets during at least 2009–2010 will be largely a function of economic growth in important host countries and the ability of emerging market MNEs to finance their own expansion. In 2008, these conditions were still favorable, as reflected in the fact that OFDI from this group of countries remained at the all-time high of US$351 billion, while world FDI outflows declined by 13%. In 2009 (and perhaps in 2010), however, it is most likely that OFDI flows from emerging markets will decline significantly. Global inflows declined by almost 40% in 2009; global outflows may decline by a similar percentage (see UNCTAD 2010; UNCTAD 2009a; UNCTAD 2009b).[13] For the BRICs, the outlook is mixed, judging from data for the first few months of 2009 (table 1.4). In the end, the extent of the decline will mostly be a function of the depth, length, and widespread nature of the economic crisis and associated difficulties, mirroring the decline of FDI flows worldwide.

At the same time, however, this does not change the fact that MNEs from emerging markets have become—and will remain—important players in the

Table 1.4 Outward FDI flows from the BRIC countries, 2008 and 2009 (US$ billions)

Country (Period)	2008	2009	Percent Change
Brazil (January–May)	7.5	0.9	–87
China (January–June)[a]	25.7	12.4	–52
India (January–March)	5.7	4.8	–16
Russia (January–March)	15.8	12.9	–18

Source: EIU database.

[a]Nonfinancial sector.

world FDI market. This in turn raises a number of issues for the host and home countries of emerging market MNEs, several of which are discussed in this volume.

1.3 Global Players from Emerging Markets: Challenges Ahead

The current financial and economic crisis presents significant challenges for emerging market MNEs and governments alike, as section 1.2 detailed. In the short term, the attentions of key actors will doubtless be focused on responding to these challenges. While the current crisis may have changed, at least temporarily, the order of priorities, numerous other challenges, inherent in the rise of these new global players, persist. This section addresses a number of these challenges from the perspective of MNEs, home countries and host countries, and considers the path ahead and the investment promotion, economic and legal challenges that emerging market MNEs should anticipate.

1.3.1 Key Strategy Challenges for Emerging Market MNEs

Perhaps the single most important challenge that emerging market MNEs face relates to their human resources. Building a successful, integrated international production network is a formidable challenge. To do so through the successful integration of acquired firms is an additional challenge. It places considerable demands on their human resources, in particular on their managerial skills and capacity. Moreover, the scale of the challenge is relatively greater for emerging market MNEs: internationalizing often at an early stage in their development, they have had less time to develop such skills and capacities.

Those emerging markets that have a longer and greater experience with OFDI have distinct advantages in this area. As already touched upon in section 1.1.3, Jaklič and Svetličič (chapter 11) underline the importance of human resources in the success of Slovenia's leading MNEs. The fact that most Slovene MNEs are not "transition babies" (chapter 11, 198) has enabled them to develop management skills, expertise, and an understanding of international markets, especially of those of the former Yugoslavia. The authors consider management expertise to have played a crucial role in

OFDI. In particular, familiarity with the western Balkans and the ability to adapt management styles to the particular context and business culture of these markets has been critical to the success of Slovene MNEs. However, a certain lack of mobility among managers, sometimes unwilling to disrupt a comfortable life in their home country to work abroad, threatens the continued success of Slovenian MNEs.

Emerging markets MNEs that have undertaken OFDI more recently are less likely to have built up expertise and capacity in integrating acquisitions and managing foreign affiliates, a gap that may be further compounded by an unwillingness to hire nonnational managers. Resende et al. (chapter 7) highlight the fact that levels of foreign employment among leading Brazilian MNEs are almost half those of the 100 largest developing country MNEs. This low level is the result of a combination of two factors: family-controlled MNEs seeking to avoid any dilution of their control and high levels of "in-group collectivism" (chapter 7, 104). Such limitations in building an international management network do not bode well for the ability of those MNEs to create integrated international production networks.

There are also broader challenges. MNEs face the continuous challenge of balancing opportunities and risks. The rapid pace of globalization and industry consolidation has led in many cases to a mind-set of "hunt or be hunted" (Price Waterhouse Coopers 2007, 5). One illustrative industry in this respect is mining, where record commodity prices facilitated the paying down of debt incurred to pursue acquisitions. Industry players saw consolidation as essential to achieving economies of scale and synergies in operations. Today, however, the dominance of resource based firms in the OFDI of a number of emerging markets brings its own set of challenges, as highlighted for instance by Kalotay (chapter 8, section 8.5): natural-resource-based firms account for four-fifths of the foreign assets of the top twenty-five Russian MNEs, and their rapid expansion took place on the back of high commodity prices. High levels of debt coupled with falling commodity prices make for an uncertain future, in which divestiture and further industry consolidation may be the only options available.

Having developed in riskier political and economic environments, emerging market MNEs' notions of risk can be very different from those of developed countries' MNEs. The greater the level of political risk in the home country, it appears, the greater the tolerance for risk that MNEs develop. The Multilateral Investment Guaranty Agency (MIGA) (chapter 12) outlines the factors that shape perceptions of political risk for "south based" MNEs. These include the location, sector, and size of an investment, as well as the home country environment and the MNEs' experience and history in outward investment. Interestingly, in terms of entry mode, while greenfield investments are considered economically more desirable and less politically risky in developed countries, emerging market MNEs consider them more risky in other emerging markets since "the presence of a domestic partner tends to reduce risk perceptions" (chapter 12, 228).

Corporate social responsibility, the means by which MNEs may balance their increasingly important role in economic development with their growing responsibilities toward the country in which they operate, is another area that presents potential challenges for emerging market MNEs. As George Kell and John Gerard Ruggie stated (1999, 15), "Globalization may be a fact of life, but it remains highly fragile. Embedding global market forces in shared values and institutionalized practices, and bridging the gaps in global governance structures are among the most important challenges faced by policy makers and corporate leaders alike." For the leaders of emerging market MNEs seeking to invest in developed countries, this challenge is potentially even greater. Their ability to adapt to and successfully negotiate the cultural references, standards, and practices of developed markets is critical to their success in these markets—and may ultimately have spillover effects in the home country, leading, in the longer term, to harmonization of standards upward.

1.3.2 Challenges for Home Country Policies

Today, while the landscape of home country OFDI policies is very uneven, the vast majority of emerging markets do not provide a supportive environment for the OFDI activities of their firms, placing them at a competitive disadvantage vis-à-vis their developed country counterparts. The principal challenge for home country policy in emerging markets is, within the constraints of limited resources and widespread needs, to create an environment and policy framework that supports domestic firms. This framework should enhance their competitiveness, enable them to compete effectively in the global arena and, ultimately, secure the benefits of OFDI for the home country. Certainly, the substantial rise in outward investment from emerging markets is a relatively new phenomenon, and national policy is not written or rewritten overnight. On the one hand, if emerging market firms are disadvantaged by a continued lack of supportive policies, and thus are hampered in their competition on the world market, they may, in extreme cases, shift their base to another country in order to stay competitive. On the other hand, the scope of government action and policy-making is constrained by economic reality—limited resources, scarce foreign reserves, and potential concerns over the export of capital and jobs.

The lack of a supportive policy framework in developing countries stands in contrast to developed countries, which have built an extensive and comprehensive policy framework over decades, policies that have evolved in tandem with, and complement, their economic situation. The result has been a gradual but persistent shift in home country policy from restricting and controlling OFDI, to permitting it, and finally to promoting OFDI actively, reflecting the recognition that, in a global market, firms must be globally competitive, with OFDI being one source of such competitiveness.

The experience of developed countries in building a policy framework for OFDI offers lessons for policy makers in developing countries. Peter Buckley et al. (chapter 13) examine this question. In the aftermath of World War II, early restrictions on OFDI focused on capital and foreign exchange controls. Gradually phased out by the early 1980s, these controls were finally eliminated as a global capital market became reality. From restrictions on OFDI, developed countries adapted policies to shape and, ultimately, promote OFDI. The authors group these measures into seven categories: "(i) the provision of information and technical support, (ii) financial support, (iii) fiscal incentives, (iv) investment insurance and guaranteed, (v) support of national champions, (vi) international investment related concordats and agreements, and (vii) official development assistance (ODA) programs" (chapter 13, 262). However, as the authors note, even with a detailed understanding of the policies implemented in developed countries, challenges remain for emerging markets. While the lack of a clear policy framework leaves domestic firms at a competitive disadvantage, changing the situation is not without its own challenges, given the lack of domestic experience and competence in this area, the risks of regulatory capture, and the absence of a significant social safety net. Importantly, the authors note that "[i]n many respects, the lessons for emerging markets are... less in terms of policy and more in terms of management and other types of human capital augmentation at home" (chapter 13, 271).

Information on the experiences of developed countries and the different policy options available is useful for emerging markets, but how applicable is it? Furthermore, even with this information, the challenge of sequencing shifts in policy remains. Filip De Beule and Daniël Van Den Bulcke (chapter 14) address the challenge that such shifts present for emerging markets, acknowledging that the fact that emerging market MNEs may be "born global" or may skip stages of development and internationalization does nothing to lessen the complexity of the policy makers' task. Despite greater access to global capital markets and the reduced importance of capital controls, for instance, emerging markets must still address real concerns over capital flight. They must try to minimize the undue influence of firms whose close links with government allow them to shape policy to their advantage. Overall, rapid globalization and the early internationalization of emerging market MNEs render redundant some of the policy lessons from developed countries. It seems likely that emerging markets, rather than moving neatly from one distinct phase to the next on the "restriction-permission-promotion" scale will instead combine elements of policy from different stages, the selective promotion of OFDI, for example, with retaining elements of control.

China is an example of how one particularly important emerging market has addressed the challenges for home country policy and, in particular, the shift from OFDI restriction to promotion. Qiuzhi Xue and Bingjie Han (chapter 15) offer a detailed examination of the nature and evolution of China's government policy. China's OFDI policy has evolved in three phases from 1984 to 2008. Adopted largely out of economic necessity in 1984, early policy involved strict controls on OFDI: from project approval by the National Planning Commission or State Council to limits on project value and the repatriation of all foreign profits. By 1991, the domestic policy environment had liberalized gradually, and OFDI's role in economic growth was endorsed. From 1991, OFDI policy focused on large SOEs, which, under close government supervision, became the primary actors in Chinese OFDI. Even though capital and currency controls were slightly loosened, the government delineated the areas of foreign activity, with approval required for all projects above

US$1 million. In 2000, funds were established to encourage the internationalization of small and medium-sized firms. The year 2000 also saw the unveiling of China's "Going Global" policy and the differentiation of OFDI policies into policies of regulation, guidance, and support. This involved the simplification of the approval process; an increase in the threshold value of projects for which approval was required; the dissemination of information on investment projects; the development of government guidelines; and the dissemination of information on problems previously experienced. China offers a particularly interesting example: it embraced "Open-Door" policies only three decades ago but, in a relatively short period, OFDI flows have grown considerably, from only US$44 million in 1982 to US$51 billion in 2008. Furthermore, the prominent role of SOEs in the Chinese economy and the country's OFDI allows the government a degree of direct influence, impossible for most other national policy makers. Yet, despite the highly structured process and policies in place in China, the authors acknowledge that this remains a "trial and error path" (chapter 15, 318).

The term "emerging markets," the grouping together of developing countries and transition economies, risks giving the impression, falsely, of a homogenous group of countries. It should also remind us of the limitations inherent in any attempt to construct one policy framework that fits all emerging markets. The key to successful policy is to ensure that it is appropriate to the stage of development of the national economy. In the case of South-South OFDI, policies adopted include the creation of dedicated Export-Import (EXIM) banks and development finance institutions (DFIs). In 2006, a "Global Network of Export-Import Banks and Development Finance Institutions" was launched "...to boost agreements between developing-country EXIM Banks and DFIs to reduce costs of trade between the world's poorer nations...spur cross-border investment, make financing more readily available to new and innovative business ..." (UNCTAD 2006, 218). Moreover, in many cases South-South investments enjoy preferential treatment, and the cost of doing business is reduced with the provision of political risk insurance through MIGA.

Until recently, the challenges presented by political risk have been viewed largely in the context of MNEs from developed countries investing in emerging markets. MIGA (chapter 12), presents the results of recent surveys undertaken in this regard. Interestingly, whilst most actors anticipate an increase in political risk in the years ahead and, in the case of investments in developing countries, consider political risk to be a greater challenge than economic risk, the reverse holds true for MNEs from emerging markets: these are more concerned with economic factors, such as exchange-rate risk. Fortunately, governments, alone or in conjunction with the private sector, possess the ability to minimize the impact of political risk on investment decisions through the provision of insurance, a policy tool that should become an increasingly important element of home country policy in emerging markets. For home countries, this raises the question of whether they should offer their own insurance schemes for OFDI, to complement what MIGA offers (and similar to what most developed countries and China do).

Where national champions or SOEs from emerging markets undertake OFDI, this poses potential political challenges for the home country as much as for the host country. Whilst a relatively small share of total OFDI in most emerging markets, as SOEs move abroad and "grow up," they will seek greater independence in determining their own economic future, free from political constraints. Harry G. Broadman (chapter 16) addresses the quandary for home country policy makers of retaining control without hindering the competitiveness of the MNE. He surmises that, as they mature, emerging market MNEs will seek to define objectives and strategy based on economic rather than political considerations. The question of how the home country will respond remains unanswered. Moreover, should state and business interests diverge, the role to be played by public opinion—on which little information is available today—remains unclear. Broadman does offer some evidence of public resistance to the outward investment activities of emerging markets. This suggests that concerns over the export of jobs not only outweigh notions of "national victories," but are as relevant in emerging markets as in developed countries—something policy makers will find increasingly difficult to ignore.

1.3.3 Challenges for Host Country Policies

The rise of outward investment from emerging markets presents its own set of challenges for host country policies, the greatest of which is increasing FDI protectionism, particularly in the case of emerging markets MNEs making acquisitions in developed countries. That the firms being acquired may be deemed to be part of a "strategic sector," thereby raising concerns over national security, and the acquiring firm is a state-owned enterprise or a sovereign wealth fund, only amplifies host country concerns. Host country apprehension—founded or not—that certain acquisitions are driven by political rather than commercial concerns will do nothing to reduce levels of protectionism. Unchecked, this rise in protectionism could inflict damage on the continued integration and smooth functioning of the global economy. Protectionism on the part of developed countries, the main proponents of liberalization, as a response to the emergence of new players would smack of hypocrisy and would deprive host (developed) economies of the widely recognized benefits of FDI. Restricting the access of these new players to developed markets would deny their firms vital access to new skills, technologies, and markets, and, ultimately, would deny opportunities for growth and development—both for the firm and the home economy.

The theory of FDI states that, through positive spillovers and backward linkages, FDI is an important means by which host countries acquire, for instance, technological assets, new management techniques, and skills (see UNCTAD 2001). FDI may improve overall efficiency and, through exports, facilitate entry into new markets. In short, FDI is the "passport" into the international division of production, which can improve the economic performance and competitiveness of the host country and indigenous firms. These are all considerations of particular importance to developing countries when it comes to admitting emerging market MNEs.

In light of ever-stronger competition for reduced FDI flows globally, however, there is concern that host countries will be tempted to lower regulatory standards and increase financial and fiscal incentives. Policy makers and decision makers, however, must use such scarce resources prudently, carefully focusing on sectors that could benefit most from FDI. The extent to which a host country can secure benefits depends on the type of FDI it receives, its level of development, its absorptive capacity, and, finally, host country policies. The promotion of FDI and the financial and fiscal incentives offered should be carefully measured against investments in training and building the necessary skill sets, capabilities, capacity, and infrastructure in the host country.

In spite of the broad acceptance of the benefits of FDI by all actors, economic nationalism is increasingly apparent in host country policies, most visibly in the broader use of the term "strategic assets" and in the decision by more countries to introduce U.S.-style approval bodies.[14] The rise of global players from emerging markets—the "new kids on the block" or "global upstarts"—is likely only to feed this trend: where foreignness is considered a liability, they are viewed as even more foreign.

Judith Clifton and Daniel Díaz-Fuentez (chapter 17) consider the response of the EU to the rise of outward investment from emerging markets. They find that resistance is not limited to FDI originating in emerging markets: individual EU members are showing themselves to be equally resistant to certain investment from other EU markets and to pressure from the European Commission to continue liberalization. This resistance stems from a reluctance to liberalize investment in sectors in which "national champions" play a role, as these are often deemed to serve political economy and national welfare purposes. Despite this resistance and differences between the degree of openness of individual member states and across sectors, the EU has one of the world's most open investment regimes. Complicating the situation is the fact that national security policies, established at the national level, stand alongside single-market policies developed and monitored at the level of the EU institutions. The current economic downturn is likely to delay further harmonization of policy and policy-making.

The rapid rise in OFDI from China in the past decade and the dominant role played by SOEs in this outward investment represents a challenge to host country policy, especially for the United States. China is the U.S. government's largest creditor; it holds approximately US$1.5 trillion in dollar assets and has total foreign reserves of at least US$2 trillion. In the ten years to end-2007, China has invested almost US$79 billion abroad (http://stats.unctad.org/FDI/), and nowhere has this generated more debate and discussion than in the United States. The fact that the vehicle of choice for most of this OFDI has been mergers and acquisitions only exacerbates tensions. As Karl P. Sauvant explains (chapter 18), policy in the United States has become more cautious in recent years, especially with regard to Chinese firms. National security concerns play a more important role in shaping this policy, fed by fears that Chinese investment decisions are driven as much by strategic and political motivations as by economic motivations. This situation is not completely new, however. Japanese investment once stirred up similar fears, which were successfully allayed when Japanese firms worked closely with the different stakeholders in order to become "insiders" (Milhaupt, 2010).

The need to address and allay concerns that feed growing economic nationalism and FDI protectionism is not limited to MNEs, home and host country governments: this situation highlights the important role that international organizations must play if the international investment regime is to remain relatively open, transparent, and stable. Critics of FDI frequently speak of a race to the bottom in terms of national standards, taxation regimes, et cetera, and a race to the top in terms of financial and fiscal incentives, all to the detriment of the host country (Dorgan and Brown 2006). These voices have become louder with the current financial and economic crisis as competition for FDI flows has become stiffer. (See, for example, the Statement by Supachai Panitchpakdi, Secretary-General of UNCTAD, May 4, 2009f.) (Contradictory as it may appear, we are witnessing an increase in economic protectionism at the same time as countries compete ever more fiercely for declining FDI flows.) With the rise of global players from emerging markets, FDI's critics add that emerging markets will apply their lower domestic standards in the host country to the detriment of workers, local firms, and the environment (Dorgan and Brown 2006). Whilst this argument is refuted by those (Fletcher 1999) who claim it is merely sophisticated protectionism, it is evident that an international framework, establishing best practices and minimum standards, and bringing greater transparency to the now truly international investment regime, is to the benefit of all actors.

Anthony O'Sullivan (chapter 19) considers how trust can be returned to the international investment regime, and looks at the facilitating role that the Organisation for Economic Co-operation and Development (OECD) can play. He outlines proposals that would ensure that "freedom of investment" is the case in all countries and for all firms, in order for the potential benefits of FDI to become a reality. These steps include the use of the OECD's forum for intergovernmental dialogue, which seeks to reconcile continued freedom of investment with concerns over national security, by OECD members and nonmembers alike. Foreign investment that makes, and is seen to make, consequential economic contributions in the form of, among other things, employment, innovation, and value added, will reduce support for economic nationalism. However, if the OECD is to retain credibility within emerging markets and successfully to engage global players from emerging markets, it must seek greater involvement of emerging markets in the evolution of policy instruments and agreements.

1.3.4 The Path Ahead

Twenty years ago, outward investment from developing countries accounted for less than 5% of total outward investment (table 1.2). The Soviet Union had just reintroduced the right of private ownership in an attempt to stimulate its economy. A decade later, the Asian financial crisis devastated economies across the region and beyond. Today, as global players from emerging markets appear on the world stage, the world is suffering another financial and economic crisis. Looking ahead, what are the challenges facing FDI and the main actors in this process? Will the current economic downturn require the main players simply to ride out this crisis, with normal business resuming as soon as possible? Alternatively, will the combination of the rise of global players from emerging markets and the current financial downturn require that the rules of FDI be rewritten?

Securing inward investment at a time of decreasing FDI flows and increasing competition for these flows represents a significant challenge for investment promotion agencies (IPAs). Significant as they are, these are not, however the only challenges facing IPAs. As discussed in section 1.1, an ever-greater share of FDI flows now comes from markets in which IPAs have had little experience to date, and this at a time when IPAs face budget and resource constraints. As if this did not render the task at hand sufficiently complicated, Henry Loewendahl (chapter 20) identifies additional challenges for IPAs in the changing global economy. IPAs must broaden their focus from greenfield investments to include also strategies for attracting and integrating M&As as well as joint ventures, alliances, and partnerships. In terms of potential sources of funding and backing of FDI, IPAs should also revise their strategies to incorporate the increasingly important role of sovereign wealth funds and the diaspora—especially important with regard to India and China. Finally, identifying and exploiting growth sectors remain as important as ever, albeit more difficult in an economic recession, when investment and research and development spending is often cut back.

The growing importance of OFDI from emerging markets not only increases competition, it also changes the very nature of this competition. Gary Hufbauer and Matthew Adler (chapter 21) underline some of the immediate effects that this new competition will have on other markets, both emerging and developed. Lower costs and lower taxes can no longer be the key selling points for host countries seeking to secure FDI from emerging markets, in a situation in which MNEs already enjoy low costs and low taxes in their home countries. Moreover, for developed country MNEs, competing directly with emerging market MNEs in acquisitions (and possibly losing) is an unfamiliar situation and, in some cases, has resulted in accusations of "subsidized capital." This may be the case when SOEs and SWFs, whatever their country of origin, are behind an acquisition. But it is difficult to determine how much merit this argument holds; it is even more difficult to prove it and to advance remedial action. It may be that this situation will become more familiar in the years ahead.[15] As FDI grows further in importance, this will contribute to the regular challenges that any phenomenon of this size poses, now and in the future.

On the scale that we see today, emerging markets as sources of investment are relatively new, but FDI itself is not new. It is one of the most important means of transferring technology and know-how around the globe. It dwarfs trade in terms of the sale of goods and services in foreign markets, involving, as it does, more than 800,000 foreign affiliates around the globe. José E. Alvarez (chapter 22) outlines the changing legal framework for investment, including the characterization of emerging market MNEs as more tolerant of risk and, therefore, less demanding of the legal system; increasing political and regulatory risk; the rising number of investor-state investment disputes; and resistance in some quarters to the shape of new investment law. Anticipating the possible impact of this changing legal background, he rejects the notion that a country's legal infrastructure is of limited importance to investors from emerging markets, arguing that it is an integral part of a country's infrastructure and contributes to the predictability with which MNEs can do business there. Furthermore, he suggests that, amongst other changes, the fact that emerging market MNEs internationalize at an earlier stage of their development, will thus do not want to "offend their hosts by filing a formal complaint" (chapter 22, 437), and are less "lawyered up," will make them more likely to follow a conciliation rather than arbitration route. This stands in contrast to the actions of MNEs from the most established home countries, the United States and Western Europe. Despite being longtime proponents of free trade and FDI, the increasing influence of politics on their rule-making risks reversing decades of progress in this area, setting a poor example for new players, and consolidating a recent trend of legislation that restricts, rather than enhances, FDI. At the same time, however, the international investment regime must take into account the interests of all its principal stakeholders if it is to maintain its legitimacy.

Conclusions

This chapter has sought to place the rise of emerging market MNEs in context, examining the role of these new global players in global FDI flows, how this is likely to evolve in light of the current economic downturn, and the challenges inherent in their rise for MNEs themselves as well as for home and host countries. Whatever the tensions and temporary setbacks, the great number of firms undertaking FDI will build an ever more interconnected and integrated international production system. The final chapter (chapter 23), by Stephen Thomsen, looks at many of the same issues related to the emergence of an integrated international production system from a thematic angle, bringing in insights from the discussions at the Conference on which this volume is largely based. In particular, he underlines that OFDI from emerging markets is "different only by degree" (chapter 23, 459)—despite the rapidity of its growth and the fact that many emerging market MNEs lack comprehensive proprietary assets. Furthermore, rather than focusing on differences between emerging market MNEs and their developed country counterparts, it is vital to understand why different emerging market MNEs adopt different approaches to OFDI, as well as their effects.

Thomsen highlights the risks inherent in OFDI unless emerging market MNEs acquire new skills, both organizational and political, and adopt the principles and practices of corporate social responsibility: in short, past progress is no guarantee of continued success. Finally, Thomsen identifies areas in which further research is essential if we are to deepen our understanding of OFDI from emerging markets. These include the effects of the different ownership structures and funding systems and the advantages that such investments can transfer from MNE to host country.

All this, finally, needs to be seen against a basic fact: countries do not look at FDI as an end in itself. Rather, it is seen as a tool to advance their development, be it as a home country or host country. As part of that, FDI is a powerful means to help countries in their integration into the world economy. In addition, economic development through integration into the world economy is one of the means by which countries lift themselves out of poverty. Much progress has been made in recent years (some of this threatened by the current economic and financial crisis), yet much remains to be done—and the greater the number of firms involved in this process the better it is for all of us.

Notes

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1. According to UNCTAD terminology, the group of "developed economies" comprises the twenty-seven member States of the European Union, plus Australia, Bermuda, Canada, Gibraltar, Iceland, Israel, Japan, New Zealand, Norway, Switzerland, and the United States.

   "Emerging markets" comprise both "developing countries" and "transition economies." The "transition economies" group consists of the six countries of Southeast Europe (Albania, Bosnia and Herzegovina, Croatia, The FYR of Macedonia, Montenegro, and Serbia) as well as the twelve countries of the Commonwealth of Independent States (CIS): Armenia, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, the Republic of Moldova, Russian Federation, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan. All other countries are "developing countries."
2. See also the overview of the twenty-five largest Russian MNEs compiled by the Skolkovo Moscow School of Management and the Vale Columbia Center, available at http://www.vcc.columbia.edu/documents/2008RussiaRankings—SKOLKOVO.pdf.
3. The BRIC country group comprises Brazil, the Russian Federation, India, and China.
4. According to UNCTAD, SWFs invested US$10 billion in OFDI projects in 2007. Private equity funds invested more than US$460 billion in OFDI projects during the same year (UNCTAD 2008, 20).
5. For a discussion, see Sauvant (2009). But this negative reaction has abated in light of the financial crisis and recession; see Fotak and Megginson (2009).
6. Vale acquired Inco, Canada's second largest mining company, for US$18.9 billion in October 2006.
7. For an illustrative list of cross-border M&A deals of Chinese financial institutions, see Deutsche Bank Research (2009b, 34). See also the list of Chinese OFDI transactions in table 10.1 of chapter 10.
8. It is, however, difficult to determine whether a specific divestment is caused by the crisis or is part of the normal course of action as part of a broader corporate strategy.
9. See, for example, the criticisms in the Chinese media of the acquisition of a stake in Blackstone by the Chinese Investment Corporation, *Securities Times*,

October 17, 2008 (http://www.howvc.com/Html/economy/macro/china-road/82605.html).

10. But this may be changing slightly: see Fotak and Megginson (2009).
11. During the Asian financial crisis at the end of the 1990s, a number of MNEs headquartered in developed countries acquired firms in the affected countries, sparking a discussion about fire-sale prices. Looking back at 2008, there are examples of what appeared to be bargain asset purchases, such as the sale of the European and Asian operations of Lehman Brothers to Nomura Holdings, Mitsubishi UFJ Financial Group's investment in Morgan Stanley (UNCTAD 2009a, 32). Even earlier, and at less distressed prices, several (portfolio) investments by SWFs into the U.S. financial sector had taken place, albeit below the 10% equity/voting rights threshold, above which an investment was regarded as the acquisition of "control" and thus subject to screening by the Committee on Foreign Investment in the United States (see Plotkin and Fagan 2009, 2).
12. The Group of 20 recognized this possibility in its Communiqué adopted November 15, 2008 when it called for a one-year moratorium on protectionist measures. See, Group of 20, "Declaration: Summit on Financial Markets and the World Economy," November 15, 2008, athttp://www.globalpolicy.org/images/pdfs/1115g20.pdf This call for a moratorium was repeated in the Group of 20, "The Global Plan for Recovery and Reform," April 2, 2009 (available at http://www.g20.org/Documents/final-communique.pdf). There is also the possibility of OFDI protectionism; i.e., governments of emerging markets restricting or discouraging OFDI by firms from their countries.
13. A survey undertaken by UNCTAD during February–May 2009 (to which 241 responses from firms were received) concluded, among other things, that "Firms are very concerned about the short-term evolution of their business environment. Almost 90% of them are pessimistic or very pessimistic about global FDI prospects for 2009....About 58% of the respondents reported their intention to reduce their FDI abroad in 2009 compared to 2008, with nearly one-third of them anticipating a large decrease (more than 30%) compared to 2008" (UNCTAD 2009h, 2). For an analysis of FDI prospects based on the number of greenfield projects, see (Loewendahl 2009).
14. Committee on Foreign Investment in the United States (CFIUS).
15. MNEs from developed countries also enjoy various forms of support by their home country governments.

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