TECHNOLOGY TRANSFER THROUGH FOREIGN DIRECT INVESTMENT TO DEVELOPING COUNTRIES – THE ROLE OF HOME COUNTRY MEASURES

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Summary

Foreign direct investment (FDI) is a major channel of technology transfer to developing countries. But, not all developing countries are able to attract FDI flows for various reasons. The debates on issues relating to FDI to developing countries and its impact have mainly focused on the strategies of the investing firm and the policies of the host countries. Studies show that the macro policies and the business environment of host countries play a vital role in attracting FDI as well as in deriving full benefits of FDI. However, the third key agent in the process, the home countries and the influence of their policies on the direction of FDI flows and in creating a positive impact on host countries has received very limited consideration.

The international community is now turning its attention to the role of the home countries in improving the quantity and quality of FDI to developing countries. This paper examines the extent of measures adopted by home countries in order to influence FDI flows and technology transfer to developing countries by studying how they promote outward investments. The main findings are, first, that outward investment agencies are presently exerting limited influence in directing the FDI flows to developing countries and even less to least developed countries, although they have the capacity to do it. Second, the agencies do take into consideration the development impact in the recipient countries, but the actual measures for technology transfer and the

creation of linkages are mainly hortatory.

1. Introduction

In recent years, the issue of home country measures for technology transfer to developing countries has gained prominence, particularly in the international agreements. Home country measures are regarded as capable of increasing the flow of resources and knowledge to the countries that require them most but cannot acquire them through market mechanisms. This paper examines whether home country measures can play a role in increasing the quantity and quality of FDI to developing countries.

The studies relating to foreign direct investment (FDI) flows to developing countries mainly deal with the question of what host countries have to do to attract and reap the full benefits of FDI and less with the role of the home country. The role of the host country is crucial for attracting and absorbing FDI, but there is also potential for improving both the quantity and quality of FDI by means of home country measures and thereby contribute to a positive development in recipient countries.

This important role of home country measures has been recognised by several multilateral organisations. For instance, the Agreement on trade-related intellectual property rights (TRIPS) has a provision on the role of the home countries: “Developed country Members shall provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology transfer to least-developed country Members in order to enable them to create a sound and viable technological base” (WTO, TRIPS, Art. 66.2). Subsequent to the Agreement on trade-related investment measures (TRIMS), which reduced host country regulation on inward investment, the home country measures have assumed greater importance in the context of development in host countries.

FDI is probably the main channel of technology transfer, including both technical and managerial know-how as well as various types of spin-off effects. For some countries, it is not easy to attract FDI due to its tendency to concentrate. FDI flows are primarily concentrated within the so-called "triad" countries, i.e., the EU, the USA and Japan. Some FDI goes to the more prosperous developing countries, mainly the newly industrialised economies. The developing countries’ share of total FDI is, however, decreasing. According to UNCTAD (2001a), their share - in the year 2000 - constituted 19 percent as opposed to 30 percent just ten years ago. The group of Least Developed Countries - the 49 poorest developing countries - got only 0.35 percent of the worlds FDI flows and 1.8 percent of total FDI received by developing countries. Moreover, the Least Developed Countries are less equipped for reaping the benefits of even this limited FDI inflows, owing to structural difficulties.

Therefore, new initiatives to improve the quality and increase the flow of FDI to these countries are needed. The home countries can step in to complement the efforts of host countries. Many home countries have outward investment promotion activities, which are implemented by the outward investment agencies. Hence, the activities of these agencies may provide an indication of the home countries’ policies on outward investment and their implementation.

Outward investment can serve two main purposes. The first, facilitate development in the host countries through FDI, since it is believed that it has a greater impact on development than many of the traditional aid instruments. The second, outward FDI to developing countries can also assist the home country industries. Support for outward investment can change the incentive structure of the firms and can thus make developing countries more attractive investment locations. While some of these home country measures may have altruistic elements, outward investment promotion also has commercial benefits as an important consideration.

What are home country measures?

Policies on outward FDI stretch from being prohibitive, to permissive and to being promoting. The prevailing tendency is that governments are recognizing that outward investment plays a central role in enhancing enterprise competitiveness and home country performance. UNCTAD (2000b) has defined home country measures as "those policy measures taken by the home countries of the TNCs that are aimed to encourage outward FDI to developing countries, and in particular to the least developed countries".

The measures that the outward investment agencies implement, through assistance to their firms, can be grouped as follows: (1) Information provision and technical assistance; (2) Financial support and investment insurance; (3) Measures to promote technology transfer.

1. Information provision and technical assistance encompasses all measures relating to the pre-investment phase. The primary activity is to disseminate information on FDI opportunities and the investment climate as well as establishing contacts through seminars, workshops, match-making and investment missions. Thereby the link between potential investors in the home country and the investment opportunity in the host country is created. As UNCTAD (2000b, p. 6) has noted, when dealing with developing countries, this is an asset because "the initiatives help to overcome market imperfections and structural deficiencies that often work to the disadvantage of developing countries, especially when an economy's relatively small size, geographic distance or limited prior experience with foreign investors tend to exclude it from customary lists of prospective FDI sites".

2. Measures relating to financial support include support for feasibility studies and project development as well as grant, loans, investment insurance and/or equity participation. The purpose is to make possible the investments that would not have taken place without the financial support and reduction of the – maybe perceived - higher risk.

3. The measures to facilitate transfer of technology can be divided into three groups: The first consists of support for the creation of technology partnerships between firms from developed home countries and developing host countries. The aim is to strengthen firms in developing countries, by providing direct access to advanced technologies and/or "learning opportunities" that arise during co-operating with

foreign firms. The second group consists of measures to promote the transfer of specific technology. This is frequently seen in the environmental arena, but also in other areas, such as in infrastructure projects. The third group consists of measures relating to research and development (R&D). These measures may be targeted at the specific technological problems of developing countries.

This paper is structured as follows. Section 2 contains the analytical framework, which is drawn from a review of theoretical explanations on FDI and its impact on host countries. Section 3 presents an analysis of the empirical findings of a questionnaire survey on the way the home country measures are implemented by outward investment agencies and how they relate to host country impacts. Section 4 provides the summary and conclusions.

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Biographical Sketch

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