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**Recent Trends in Foreign Direct
Investment & Trans National
Corporate Behaviour Key Lessons
and Implications for Pakistan**

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Recent Trends in Foreign Direct Investment & Trans National Corporate Behaviour

Key Lessons and Implications for Pakistan

Faisal Haq Shaheen

Introduction

The acceleration of global economic integration has prompted many neo liberal economists to regard foreign direct investment as the elixir of economic revival for developing economies. However, while it can extend efficiency and productivity of a free market concept to developing countries, it brings a series of risks that expose marginalized domestic sectors and consumers to the ruthless and often volatile economic environment of the free market.

Liberalization of trade and opening of markets to foreign investor flows has exposed inefficiencies and limitations of the developing governments' attempts to foster a productive, progressive and competitive domestic economic environment, capable of producing firms that are competitive in the global marketplace.

Though corrupt and nepotistic elements have been reduced in the domestic investment sector, new flows of capital need to be developed to fill the void. Limited availability of domestic capital and dwindling foreign exchange reserves have prompted many economists to hedge 'economic revival' on foreign direct investment (FDI). Unfortunately, investors in the global economic and financial markets are scared of political instability in Pakistan. The meager FDI flows that have trickled into the region since 1990s, are witness to this fact.

While the FDI is competed for, by developing nations, corporate entities (global stockholders of the FDI flows) are surpassing the GNPs of nation states with their global revenues. Of 100 largest economies, at least 51 are corporate. A valid developing economy concern surfaces from the high leveraging power that the corporate entities have over developing economies. Trans-National Corporation (TNCs) seem to be institutional mechanisms, which exploit and extend market failures in the name of shareholders' wealth, rather than agents of global allocative efficiency. The TNC's institutional superiority arises from its ability to extract rents from other significant stakeholders such as states and workers through structurally increasing bargaining power (driven by globalization) over these groups. Industries of weak developing countries are often ill prepared to compete with the TNCs and risk marginalized market share, take-over and bankruptcy.

While the FDI is sought to bring new investment and inflows to cash strapped economies, 'sovereignty stripping' of local industry may take place. The Canadian example of the 1990s measured that up to 90 per-cent of the FDI went towards takeover of existing corporations (Clarke and Barlow, 1997:65-6). Poor countries have correlated higher capital mobility with higher the TNC bargaining power in their dealings with both governments and workers.

The TNC growth and consolidation of power continues at an unprecedented pace. In 2000, there were over 64,000 TNCs whereas in 1996, they were 40,000, and 7,000 a decade before. Rapid growth has

been experienced in services rather than manufacturing. Most of the FDIs, at least in Asia, have been in tertiary sector rather than primary or secondary sector. The TNCs vary in size and concentration of power in larger TNCs outweighs budgets of economies. In 1996, top 200 TNCs had combined annual sales bigger the combined economies of 182 of the world's 191 economies. The FDI from the 1,000 largest corporations emanates from OECD members: the United States, Europe and Japan.

Some sectors of South Asia have benefited indirectly from the short term of the new shift. For example, some 100 American firms outsource software code cutting overnight via electronic networks to India where programmers are paid 25% less than the American rate. However, if such a trend continues, long term benefits of capturing profit shares locally and growing competitive domestic firms, may be reduced to dependant sub- contracting sector.

At macro level, however, a developing state increasingly loses control to capitalist economy in its ability to control, monitor or influence what its domestic economy produces; where the resulting remittances go and adjustment of macro economic controls such as tax and interest rates. The borderless, nonsubsidized, duty-free global economy leaves little room for government intervention. The government might be more effective in assisting indigenous industry and the most isolated constituents of its population.

This paper will examine positive and negative aspects of foreign firm involvement in developing economies with specific reference to Trans-National Corporations, the most common entry vehicle of the FDI. The discussions and debates on this topic during the past decade, having relevance to the recent developments, will be paraphrased and summarized. Following analysis and a few case studies, we hope to have in place a framework on expectations from the TNCs, which is required by developing governments to deal with their coming and increasing undermining of the policy that they bring in (vis-a-vis the World Trade Organization (WTO) agreements and liberalization policies under the IMF and the WB).

We are concerned that in absence of strong domestic investment, sector leverage and local industrial power, the FDI will become more a tool of serving foreign economic interests at home rather than development of the nation.

Polarization of Global Market Power

It is argued that competitive investment markets, unhindered by government regulation operate more efficiently than state controlled markets. Therefore, neo liberals argue that governments should welcome foreign direct investment and do as little as possible to regulate it. The TNCs are believed to contribute to development process by bringing in financial resources, employment, technology transfer, export growth and diversification, market access and skills, increased savings, broadening tax base and increasing availability of consumption and investment goods by cost reduction of public utilities in short and long run.

However, counter arguments point out significant market failures characterizing the TNC investment process in its relationship to the developing countries. Essentially, there is a wide gap between profit maximizing intents of the TNCs and the development goals of governments. A survey of criticisms of the TNCs are as follows.

- Information failures in investment process can attract insufficient or improper FDI.

- Upgrading is a long term goal and requires significant government management.
- The TNCs might 'crowd out' dynamic local firms by attracting labor, finance and markets.
- Subsidies and tax holidays for the TNCs may constrain social and domestic commitments.
- The TNCs mechanisms of transfer pricing can siphon away resources from host countries. (Imported products, profits and factor costs sent to home country).
- Required capital is raised locally. It contributes to increased host country interest rates.
- Local capital is made even more scarce, blocking domestic investment growth, and in some cases, forcing it to be a loan financed from abroad.
- The majority of the TNC subsidiary stocks are owned by the parent company thus rendering host country's residents powerless to control/direct operations within host economy.
- Key positions are reserved for expatriates, stunting spill-over effects on host economy's labour.
- Little training is provided for host economy's workers.
- They are adamant in using capital-intensive technologies that are inappropriate for labour abundant developing economies
- Research and Development (R&D) activities and patents are concentrated in home countries and technology transfer to the host countries is restricted.
- Demand for luxurious goods in host countries is increased at a cost of essential consumer goods.
- Foreign operations are started by purchasing rather than building new productive facilities.
- Limited contribution to host countries' exports are made.
- Income distributions in host countries are worsened.
- The TNC development does not observe host country's national plans for development.
- Monopoly power in host countries results in excessively high profits and fees, while the use of "transfer pricing" enables tax avoidance. Hence, a negative pressure on balance of payments.
- Major industrial sectors are dominated.
- Accountability to home governments is not extended to host nations.
- Stimulated demand for scarce resources contributes to inflation.
- A localized brain-drain of personnel and management impedes local entrepreneurial success.
- Alliances are often formed to consolidate power with corrupt elites in a developing society.
- Interference is made in political affairs of the host developing countries.
- Impacts on consumer safety and environmental conditions are ignored.
- Social and cultural impacts are not factored into development beyond image marketing

Source: Epstein, 1999

While state regulation will mitigate some negative effects of the TNC presence, the regulation of the TNCs is becoming difficult due to a number of external forces which undermine state structures, tools and instruments.

- Bilateral¹ and multilateral trade and investment agreements into which developing countries, governments are entering often prohibit precisely the types of regulations regarding the TNCs,

1 Bilateral between a wealthy nation and a poor nation often experiences one sided benefits and bullying by the wealthier nation. A recent example is the Pakistani request for cash to be returned in lieu of the failed sale of F-16s. Instead the US responded by using the money against wheat repay. While balanced multilateral rule is deemed fair by the WTO, its experience thus far has been at the whim of the G-7.

such as performance requirements that would increase benefits of the TNC investment for workers and citizens of the host country.

- A substantial share of recent FDI has taken the form of mergers and acquisitions (M&A) rather than 'green field'² or new investments. But M&A is much less, likely to contribute toward economic development, than the 'green field' investments.
- Most of the FDI is still carried out in developed economies. In developing economies, the FDI is highly concentrated in a few countries. Of all the FDI flows in fiscal year 2000, 80% went to developed countries and 20% to developing countries.

One may conclude from these points that the TNCs are not efficient allocating agents of resources within developing economies as often asserted by neo-liberal advocates. Rather, the TNCs may be contributing to the increased world inequality.

Recent Trends in FDI and M&As

Econometric analyses suggest that there is no clear evidence of a positive connection between the FDI and economic growth. Firstly, according to the UN's 1999 World Investment Report (WIR), the TNC presence may crowd out domestic firms and, in many circumstances, there will be a need to choose between the TNCs and domestic firms. Secondly, it has been found that most of the FDI is circulated among the developed economies and of the amount directed to wards developing economies, China and a select few receive a lion's share. The 10 largest countries in terms of inward stock received 71% of the world inflows of the FDI in 1998. They are: US, UK, China, Germany, France, the Netherlands, Belgium, Luxembourg, Brazil, Canada and Spain. Virtually all 1998 FDI increases were in developed economies where growth has remained stable while in developing economies, the FDI declined slightly, cushioned by currency depreciations, FDI policy liberalization and merger and acquisition friendly policies. This concentration has increased over time as the WIR-99 indicates, wherein 1998, the top five countries received 55% of all developing countries inflows, as compared with 41% in 1990, and 48 least developed countries (LDCs) received less than 1% of the inflows.

The rapid globalization seems accelerating the trend of mergers and acquisitions (M&As) regarding green field investment. The pace of the M&As has been fast as the TNCs consolidate horizontal market power through buying-out competitors to rapidly secure market position and reducing costs. The drive behind the M&As in the developed countries has been insufficient to exploit synergies and promote partnerships. Rather it backs downsizing of staff due to shifting of work load on computers and realizing savings of centralized administrative and production processes. The International Labour Organization (ILO) recently completed a study that estimated a total sector job loss of 300,000 due to M&As in Europe's financial sector. The motive behind the M&As in developing economies has been the speed of market penetration and access to resources, providing faster returns on investment. Falling product lifecycles and rapidly changing market dynamics have made construction and fresh investment time consuming and obsolete. The global trend of the M&As suggests that most of the flows are coming in at end of the life-cycle of investment activity.

The result of M&A activity is that they shift funds from fragile developing sectors to overseas players and go for benefits from profits re-invested in developing and strengthening the local marketplace to stimulate competition. Also, with simple transfer of assets from domestic firms to foreign hands, and no initial

2 Green Field investment refers to fresh resource flows from abroad that result in the building of a new manufacturing or service based entity in a host country.

contribution to productive capacity of the host countries, issues of lay offs, asset stripping and adverse effects on market structure arise. These concerns, of course, are embedded in broader apprehensions of eroding national sovereignty, weakening of national enterprises, loss of state control over direction of national development and inherent pursuits of social, cultural and political goals. Nevertheless, while the short term effects of M&As are negative, they may be mitigated in the long term.

Table 1: Cross Border M&As versus Greenfield Investment

Short Term	Long Term
The M&As bring less productive capacity or capital stock innovations than the Greenfield investment. But, they are the next best thing to a firm's closure as they serve as <i>life preservers</i> .	The M&As are followed by sequential investment by foreign acquirers. Sometimes large, especially after privatization. Thus, over-time, enhanced investment and production may result. However, if investment comes in is from abroad, it further marginalizes the position of sovereign firms.
The M&As are less likely to transfer new or better technologies or skills than the Greenfield investment. Differing from the Greenfield, it may lead to downgrading or closure of local production or functional activities.	The M&As can be followed by technology transfer when acquired firms are restructured to increase the efficiency of operations. If local firms are crowded out, little technology transfer will result.
M&As do not generate employment for the reason that no new production capacity is created. May lead to lay offs. Again, better than the local firm going bankrupt.	M&As generate employment over time if sequential investment takes place and linkages of acquired firms are retained or strengthened. In the long run, differences between the Greenfield and M&A are reduced and elimination of uncompetitive firms and the effects of down-sizing become muted.
M&As can increase concentration in host countries and lead to anti competitive results. They can be used to reduce competition. In a worse scenario, it can prevent concentration by avoiding bankruptcies. The Greenfield, however, is better; and in Pakistan, it increases market concentration/crowding in.	Market structure can persist after entry, be it positive or negative. Anti competitive practices are more likely to be engaged in with M&As that increase concentration especially when they occur in weakly regulated oligopolistic industries.

Source: World Investment Report 2000/2001

Table 1 summarizes the preceding concerns emanated from the literature review and two new issues. Obviously, the M&As are better than bankruptcy. In the long run, they can preserve employment, capital utilization and on-going concerns in the face of limited options. Secondly, the M&As can lead to increased employment and market health if they crowd in horizontal or vertical investor interest. Problems with such a strategy arise if such investment continues to come from abroad. In absence of a national regulation, this strategy undermines the state sovereignty in the investment sector. Furthermore, if a public utility offers a service to a consumer, foreign investor capture may sway initial mandate of the public asset towards profit generation from firms, rather than inexpensive service provision to households. Consumers' concerns regarding HUBCO in Pakistan are warranted, given the consumer experience of India's Orissa power plants, which are now serving as a small fraction of intended consumers at 500% increases in initial price of power.

Transnational Corporations have also been enticed due to a myth that they are capable of generating 'high' employment in developing countries. Such a fear has been cause for many US economists to push a knowledge-based economy in the face of production shifts to developing nations. However, given the

results from the following table, the benefits in employment seem to be tilted more towards the developed countries.

Table 2: World Foreign Direct Investment stock and estimated employment generated by Transnational Corporations - 1975, 1985, 1990, 1992, 1999

	1975	1985	1990	1992	1999
Total FDI stock (US\$ billions)	289	674	1649	1932	4771
in LDCs	-	190	310	400	1438
Estimated employment in TNCs (millions)	40	65	70	73	86
Employment in parent company at home	-	43	44	44	46
Employment in affiliates in industrial countries	-	15	17	17	17
Employment in foreign affiliates in LDCs	-	7	9	12	19
In China	-	-	3	6	4.1
Employment in US TNCs	-	26	25	25	26.4
In foreign affiliates	-	7	6	7	5.6

Source: World Development Report, 1994, and World Investment Report 1994, 1999

This data clearly states while employment has increased gradually in developing countries, particularly China, the employment in the TNCs is still centered largely in the developed economies.

With respect to national trends and labour that is employed within developing nations, the TNCs provide a meager contribution in percentage towards employing various nations' labour pool.

Table 3: Data for 13 developing countries comprising 93% of the TNCs employment.

Economy	Labor Force (millions)	TNCs employment (millions)	TNCs contribution to employment (%)
China	670.0	6.00	0.9%
South Korea	19.0	0.30	1.6%
Brazil	55.0	0.90	1.6%
Mexico	33.0	0.70	2.1%
Indonesia	80.0	0.40	0.5%
Singapore	2.0	0.30	15.0%
Taiwan	9.0	0.30	3.3%
Thailand	32.0	0.20	0.6%
Total of 8 countries	907.0	9.30	1.0%
Cote d'Ivoire	5.0	0.06	1.2%
Zaire	14.0	0.07	0.5%
Senegal	4.0	0.04	1.0%
Cameroon	5.0	0.04	1.0%
Botswana	0.5	0.04	0.8%
Total 5 countries	28.5	0.24	0.9%
Rest of LDCs	1044.0	2.46	0.2%
Average of all LDCs	1979.0	12.00	0.6%
Industrial countries	375.0	61.00	16.3%

Source: World Development Report, 1994, and World Investment Report 1994, 1999

Again, the trend that appears from Table 2 is that employment generated in developing countries is negligible whereas employment generated in home countries from the TNCs is very significant. Why is there so much increased employment from the TNC investment in host economies, directed back towards the home economy? The element of transfer pricing and factor costs comes into play at this stage where

the benefits of outsourcing and sub-contracting are captured by affiliates abroad and sent home to the TNCs in home economies, generating more employment.

Table 4: Transnational Corporation, Investments, Profits on Investment and Employment (Cumulative and Percentages)

	FDI Stock	Factor Payments to abroad	Employment
Africa	2.3%	20.8%	-
Latin America	6.8%	30.8%	13.0%
Asia	10.1%	16.9%	-
Industrial countries	80.7%	31.6%	87.0%
Totals	100.0%	100.0%	100.0%

Sources: World Investment Report, United Nations, various years, World Indicators 1997, World Bank, CD, 1997

Again, we see that when factor payments from countries abroad are transferred back to home economies, they generate more employment. Evidence would suggest that these factor costs from host markets are maintained at equivalent levels to those of home economies, even though the FDI stock and employment levels are lower in host economies.

Clearly, if analysis and data from the World Investment Report review and the preceding tables is to be scrutinized in a policy sense, there will be limited benefits for employment generation through the TNC involvement in labour abundant countries like Pakistan.

Potential for Foreign Direct Investment in Pakistan

Like rest of South Asia, the FDI to Pakistan has been unstable and restricted to a few sectors. Political instability and a lack of institutional strength have been cited by international investors as major reasons which block investment. In spite of such weaknesses, the FDI has shown a gradual upward trend, from US\$100 million in 1980s to a little more than US\$300 million in 1990s. However, while the FDI has surfaced in food and beverage, textiles and agri-business; there has been a little interest in export processing zones. For example, the Karachi Port Processing Zone showed less than US\$100 million in investment since its inception in early 1980s. The FDI has been directed more towards the service sectors in the wake of privatization programmes (the FDI through bank privatization in Pakistan) and infrastructure.

At the end of 1993, manufacturing sector comprised 60% of the total US\$650 million investment. Half of the FDI is from the US, but this has declined as of late with more investment coming from Japan and Asia's newly industrialized economies like Hong Kong. Liberalization of economic policies and an opening of the power sector led to an inflow of US\$1.3 billion peak in 1994 from less than US\$100 million in 1991. However, political instability and scuttling of the independent power producers (IPPs) issue have stymied further inflows. At the risk of being premature, it is worth predicting that given the existing trends, it is unlikely that significant FDI flows will factor into economic growth.

With respect to the potential for the FDI in **private sector**, Pakistan's comparative advantage lies in agriculture and agro-based industries. Attention to mechanization of the sector, through a subsidized tractor purchase scheme seems to be leading to improved productivity. Livestock is felt to be growing even though policies have not necessarily targeted the niche in the past. Increases in textiles have been

attributed to ginning, spinning and weaving contributions, lending to the issue that textile is tilted towards lower value added items.

While the most efficient area of Pakistan's industry is textile, there is much productivity to be realized if the sector is to become globally competitive and wants to get benefit from abolition of multi fiber agreement in 2005. Removal of protection and subsidies coupled with training, skill improvement and diversification of clients through marketing of higher quality products are globally competitive. The labour intensive sector is highly protected and benefited from subsidies of many segments of value chain. The FDI may be considered in this area to increase and diversify foreign market access with particular attention to high quality products. For example, areas of weaving, finishing woolen yarn and other low efficiency areas of conversion of spun short staple and filament yarn into cloth (finished and gray) and in the conversion of imported fiber (wool) into both yarn and cloth would benefit. To increase efficiency in small scale, non-integrated units are employing simple but relatively labour intensive technology. Investing in the skills improvement in this sector may pay off dividends more than investing in new technology and will strain employment levels.

In order to compete with China, marketing quality products into selective niches will be critical. If there is a lesson to be demonstrated within the difference between India and China, New Delhi's attraction of the FDI has been a fraction of the world's total and has been directed to protected domestic sectors. China on the other hand, has directed the FDI to export-oriented economic zones. A global investor, knowing the Chinese export potential and the support policies, continues to increase investment in the sector. Coordination from the policy side and a stable business export environment may increase the competitiveness of Pakistan's export sectors while domestic policies may revive selected sick firms.

Pakistan has gradually grown away from exporting raw cotton goods and jute into more labor-intensive sectors such as textiles, leather goods and gems and jewelry. The FDI in these sectors would have to orient itself to reduce constraints to export markets without substituting for available labor. In the low wage and labor surplus market of Pakistan, where poverty is critically linked to employment levels, employing more of Pakistan's labor force while educating the existing labor force and improving their skills, is critical to growth in the global economy. It is expected that a combination of fish and seafood, gems and jewelry, machinery and equipment as well as software will contribute to the highest areas of growth in the coming years.

Corresponding with global trends, actual foreign direct investment in Pakistan has also increased in food, beverages and tobacco, chemicals, pharmaceuticals and fertilizer, financial business, textiles and construction. The FDI has been stalled due to inadequate infrastructure, inefficient public enterprises, high input costs, regulatory weaknesses, policy disruptions and governance problems.

Other concerns of international investors include ownership restrictions, performance requirements, lack of property rights protection and administrative inefficiency. Macro policy issues included protectionism, weak tax regime and underdeveloped financial system.

Pakistan, along with other developing countries, could benefit from regulated and focussed TNC involvement that were directed towards new investment in the tertiary and secondary sectors and market access for the diversification and maturation of the primary sector. However, the threats of acquisitions and take over in mature sectors such as agriculture and textiles are very real and must be examined. Furthermore, in some industries, such as chemicals, petroleum refining, and steel, capital-labor ratios are not alterable to a significant degree. Thus, capital and labor have to be combined in relatively fixed

proportion. As a result, there may be no substitute for a highly capital-intensive technology. Short and long term cost benefits for supporting such sectors need to be examined.

Finally, Pakistan is far behind the rest of the world in export of technologically advanced goods. The FDI that stimulates and brings technology transfer to the region with the promise of increasing light and heavy machinery sector exports would also be welcomed, without necessarily disrupting the composition and competing with other sectors. Information Technology growth in India exemplifies how this is possible. Microsoft, CISCO and Oracle are opening up offices and branches in Bangalore and other parts of India's silicon valley.

With regard to the **public sector**, many industries continue to show poor performance and have been proposed for privatization. These include: Federal Chemicals and Ceramics Corporation, National Fertilizer Corporation, Pakistan Automobile Corporation, Pakistan Industrial Development Corporation, State Cement Corporation, State Engineering Corporation and Pakistan Steel. Prior to considering privatization, it may be worthwhile to examine and change productivity incentives and management style. Such change may increase cost efficient service delivery more so than through the rigors of privatization.

Where privatization is finally sought for public entities, local buyers or south based consortia should be sought after before northern investors are introduced into the buying scene. Current literature in development economics presents a strong case for South – South co-operation in this regard, so that key development entities do not see their mandates fall to much under foreign influence.

For example, handing over development financial institutions and strong banking structures such as UBL to foreign power and ownership may be unwise as certain controls and valuable levers that are attached to domestic large and small businesses and economic activity may be lost. They will then be able to bring in foreign ownership of small and large industry both international and domestic. Then, foreigners will control to a large extent, the direction and growth of Pakistan's economy as in case of energy, telecommunications and transportation entities which are being offered or controlled by Japanese, German and Korean interests.

Attention must be paid to the vulnerability of the economy to external shocks as its main exports are concentrated in textiles and garments. A heavy reliance on imported energy, heavy external indebtedness and high share of volatile portfolio flows in foreign financing are also constraining. Greenfield investment in new sectors which show the most potential would be of more benefit to Pakistan, which would also crowd in firms rather than crowd out of existing mature sectors. The FDI in new markets would facilitate making Pakistan's export market more competitive.

Case Study: HUBCO/WAPDA

The most recent case being that of the power sector, between a foreign consortium HUBCO and the local distribution entity WAPDA. This may, of course, have helped Pakistan more than it harmed. By stumbling through the machinery required to support effective FDI, Pakistan has now learnt a valuable lesson in the requirement of domestic industrial policy that will support and guide the selection of the FDI, whatever is the stream of inflow. There are a few valuable issues that surface on the state and investor side of the issue which needs to be addressed.

The entire process basically linked to political instability with institutional uncertainty. To a foreign investor, the HUBCO/WAPDA fiasco is an indicator of the weaknesses in maintaining business separately from politics. Political stability, restoration of democracy and, perhaps, most importantly institutional/contractual strength and integrity preserved through another political upheaval will be required to increase investor confidence in the region. In the short term, perhaps a flagship project to restore investor's confidence and increase short term FDI will be necessary.

The TNCs and foreign investors are short term minded and negotiate in self interest rather than in the interests of the host country. While a rate of less than 50% was negotiated with Bangladesh, the HUBCO consortium attempted to negotiate a higher rate with WAPDA with full knowledge of the profit it would be incurring at the expense of the Government of Pakistan. It is up to the host country to set up, institutionalize and empower an effective domestic industrial policy instrument that will monitor, regulate and effectively negotiate such contracts, independent of activities taking place in the political arena. The fear is that with the encroaching power of the multilateral business environment under the auspices of the WTO, future disagreements will be taken to the dispute settlement process and sovereignty in negotiations will be further undermined.

Strength of domestic markets is critical to maintaining economic integrity in the developing forum of globalization. In the post war setting, the western world embraced the policies of the Reagan Thatcher era of Anglo American economic policy and privatization that saw domestic policy swing in favour of big business. In an era where healthy developed economies were experimenting with globalization and free market competitiveness, internationally active corporations such as British Airways, were sold off to the private sector, with spectacular results. However, if the Government of Pakistan chooses to privatize Pakistan International Airlines, sovereignty issues (foreign currency earnings, assets, etc.) would surface as a lack of domestic buyer strength that would risk the asset falling into foreign hands. Similarly, public uproar rose during the Vodafone – Mannesmann merger which saw a French firm buy out the German telecom giant.

Policy Implications and Recommendations

In assessing the feasibility and development benefits of the FDI, a number of questions need to be asked regarding the investment.

What is the Nature of Foreign Investment?

- A) Method of entry:
establishment of a new plant or '**Green-field**' investment, **acquisition** of existing firm, **merger** with an existing firm, **joint venture** with local firm
- B) Function:
to **extract/process** natural resources, to serve host country market (**import-substitution**), to serve export markets (**export-led**)
- C) Attributes:
industry **type**, **technology**, **scale** of operations, extent of **integration** within parent family

Where will be the major areas of the TNC impact?

- A) Capital and finance:
initial inflow of capital, capital raised locally, profits retained locally, profits remitted to parent company, transfer pricing, cost to host country of obtaining plant

- B) Technology:
extent of technology transfer, appropriateness of technology, cost to the country
- C) Trade and linkages:
propensity to export, propensity to import materials and components, use of local suppliers (extent of local linkages)
- D) Industrial structure and entrepreneurship:
effect on concentration of industry, effect on competitive position of existing indigenous firms, effect on formation of new indigenous firms
- E) Employment and labor issues:
volume of employment, type of employment (skills, gender), wage levels and recruitment, labor relations, stability

Failure to ensure that the FDI and transnational interests are compatible with the development goals of Pakistan will result in a high level of foreign control on Pakistan's economy through monopolization of sub sectors and sectors.

The results may be:

- A) potential loss of sovereignty and autonomy
- B) external dependence (e.g. on foreign technology)
- C) truncation: (fracture) of individual plants, of the economy as a whole, or of key economic sectors

The risks of the FDI are equally evident as exemplified by the liquidity crisis in Mexico and most recently the Asian flu. From the management of large flows to the volatility of short term portfolio flows (that can trigger reversals), the FDI needs to be treated with care within the fragile infrastructures of developing economies. Lack of investor confidence in domestic macroeconomic policies triggered a reversal of 4% of the GDP from Pakistan in 1994/5.

This lends credit to the case of building local investor confidence and local financial credibility before going abroad for assistance. In Pakistan, this will, of course, requires demonstrated political stability and social peace.

What is needed is an *effective, focused and policy aligned public sector investment* that is government controlled and can match national policies. *Domestic and local private sector investment* that is arguably more in tune with global competitiveness may not be as well aligned with national development policies. Privatization of public sector enterprises falls into this category. In light of the WTO push on government procurement and competition, it may be worthwhile for Pakistan to accelerate the privatization of key assets that should remain in domestic hands, before the WTO agreement pushes for greater decision making and tendering transparency that would undermine sovereignty retention of privatized public assets. An investment policy, therefore, needs to differentiate between the benefits of the domestic versus the international investor and the policy space given market dynamics and constraints.

Greenfield investment, where fresh new investment from outside investors brings capital into sectors and stimulates activity and growth.

Domestic mergers, where local firms form strategic alliances to consolidate local market strength and competency against foreign competition.

Domestic acquisitions, where local players acquire horizontally, vertically or diversified firms to strengthen their base of economic and productive activity.

Foreign mergers, where foreign investors form joint ventures with local firms in an effort to exploit common goals and use synergy. Let us consider franchised operations (particularly popular in the food and beverages sector, into this category). However, factor costs from such operations are dangerous as they experience the siphoning of royalties and franchise fees abroad which could, otherwise, be invested at home.

Foreign acquisitions Where foreign firms buy out local firms as in case of Lever brothers buying out Best Foods. This is especially on the rise and is dangerous as it puts livelihood of a corporate entity in the hands of a foreign owner and the market environment of that owners host country. For example, in late '80s and early '90s, free trade between Canada and the US resulted in the buyout of many Canadian firms by the US conglomerates (hence the birth of the Canadian branch plant economy). In the recession of the early 90s, the Canadian economic condition was worsened as many US firms chose to downsize their Canadian activities to save money rather than closing their US operations. If a market becomes lucrative and corporations become accustomed to the cyclical nature of the global market place, this may not be a concern for some sectors and companies may retain activities in a developing country. However, in an age where many of these developing countries are extremely vulnerable to shocks, even the slightest investor paranoia will have devastating effects on the economy. Case in point, the Mexican, Argentinean and Asian crises.

The last case is *bankruptcy*, which is not an investment, but does experience the loss of it. The worst case scenario for any Pakistani financial or economic entity is to be declared bankrupt, have its employees laid off and its assets sold to the highest bidder. If the assets and managerial talent are retained by local firms, there is some preservation of the value that firm contributed to the economy. However, to use the Canadian example of the major retailer Eaton's, which recently closed its doors and was sold off to various US competitors, the effect on the local sector is devastating.

Again, developing countries will be hard pressed to absorb such shocks. So, while local investment is, of course, preferable, foreign investment in partnership (joint ventures, strategic alliances) and lastly, acquisitions may be a better option for sick firms.

On the proactive level, poor, labor abundant states should focus the FDI into sectors with backward linkages into impoverished labor sectors and somehow crowd in human development. Local agents will more like such strategies than foreign entities.

On an interesting note to developing countries, the WIR also emphasizes that developing nation governments need to mobilize foreign investment that will benefit their economy. This involves two key factors of response from the domestic economy and one from the world economy.

- The **institutionalization** that has been lacking in so many regions for so many years will need to be created. Then the TNCs and the FDI will be attracted through the signal of adequate infrastructure and development may be controlled. Furthermore, labor will be more easily incorporated into the development equation, which, for all intents and purposes will also incorporate into the poverty alleviation problem.
- Policies are needed to mobilize current **domestically nepotistic and lethargic agents in the private sector** to efficiency and productivity levels that are globally competitive. Policies are needed to encourage a domestic competitive climate and prevent market capture by a few larger

foreign firms. Of course, which types of mobilization and which types of the TNCs will be most beneficial will depend on the context of each particular country. Policies that stimulate internal competition (similar to the case of Korea) are needed.

- **Consumer pressure** from the north in the form of social activism can play a major role in drawing the attention of corporate managers to the realities and actions of their foreign country subsidiaries and affiliates. This may compel larger corporations to behave differently, avoid practices that are socially damaging and take on strategies and tactics that are socially beneficial to markets in developing country.

Other policy recommendations that stem from the preceding analysis are as follows.

- **Think small.** While not as deep pocketed as their larger counterparts, small and medium sized TNCs may provide better niches in new markets and more diversified opportunities. They will also be easier to negotiate and leverage with.
- **Effective institutions** To identify markets as well as cost/benefits of the TNC involvement are crucial. Identifying linkages with export development zones, labor intensive sectors (textiles), SME industry potential (organic farming, jewelry, precious stones and handicrafts), impoverished regions and rural areas will ensure alignment with development needs.
- **Domestic sector** strengthening is needed above all to fuel the tax base and maximize employment's spill-over effects. Capital intensive TNCs cannot be counted on to provide significant employment.
- Policies to convert and encourage additional funds from **overseas Pakistanis** towards investments in the country. Linkages with overseas Pakistanis may assist in fostering of a service based industry, specifically information technology.
- Scholars go as far to say in much of the literature that **improving the efficiency** of public sector institutions through management restructuring, productivity bonuses and incentives may reap more benefits than the outright privatization.

While it is true that the TNCs are an important agents of growth, they are only important in this sense for a small number of countries and even then, they are not always an agent of real development. As a result, for most countries, a solid case of data and analyses is being built that recommends the best approach to development would be to mobilize resources and institutions for domestic economic development and sustainable growth. If such efforts succeed, the TNCs will want to enter a market rather than being coerced and baited to investment. Then, in principle, each country should be able to decide whether or not it wants the TNCs and on what terms. This ought to be the relationship between the TNCs and the development process.

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