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Global foreign direct investment (FDI) flows have been growing at unprecedented rates since the beginning of the 1990s, barring a few years in the beginning of the 21st century. As a result, the global outward FDI stock, which was just 5.8% of the global GDP (gross domestic product) in 1980 and 8.6% even in 1990, now stands at about 25%.

This growth in FDI flows has some interesting dimensions. Traditionally, FDI has flowed out predominantly from the developed countries. However, in recent years, several developing countries have become sources of FDI flows. As recently as 1990, only six developing and transition economies had outward FDI stocks of more than $5 billion; by 2005, as many as 25 developing and transition economies crossed this threshold. Total FDI outflows from developing and transition economies (excluding offshore financial centres) increased by about 15 times, from about $4 billion in 1985 to $61 billion in 2004.

Though developing countries are making investments all over the world, the larger part of their FDI is going to other developing countries. In fact, FDI flows among these economies increased from $2 billion in 1985 to $60 billion in 2004. Thus, the importance of South–South FDI has increased. It is also noteworthy that traditionally, outward FDI flows from the South have, by and large, gone to other developing countries, but in recent years, South–North FDI flows have also been quite significant.

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Another development that is observed is the growing importance of FDI in natural resources. This has become more prominent in the context of South–South FDI in particular, as till recently, South-South FDI was concentrated mainly in manufacturing and trading activities.

The causes and implications of these developments are not yet clear. While in the 1950s, trade was virtually the only means of doing international business, now FDI has become more important than trade in terms of delivering goods and services to foreign markets, as sales by foreign affiliates are significantly higher than exports. Such a reversal of importance between trade and FDI took place sometime in the mid-1990s, which is also an outcome of the same process of increased FDI flows. Given this scenario, developing countries probably found it difficult to ignore the FDI route for serving foreign markets.

Literature on FDI shows that the academic researchers have focused on the impacts of FDI inflows on economic growth and other socio-economic variables, as developing countries have generally been seen as the recipients of FDI. Though the evidence in this regard is not conclusive, it has generally been recognized that FDI could be a source of capital, a vehicle for technology transfer and better managerial practices, and could provide better access to foreign markets. But the emergence of some developing countries as major sources of FDI outflows has not only raised the question of possible impacts of such outflows on the home country but has also created a policy dilemma, as their policies, which are more oriented towards attracting FDI inflows, have not been encouraging enough to facilitate outward FDI.

For the recipient developing countries also, it is an enigma, as they wonder if FDI from other developing countries is any different from that originating from the developed countries and whether it requires different policy treatment. UNCTAD's (United Nations Conference on Trade and Development) *World Investment Report 2006* observes that FDI from developing countries creates more jobs compared to its developed world counterpart. However, such a comparative assessment on issues like technology and forward and backward linkages is not yet available.

The present issue of *GALT Update* intends to throw some light on these issues without attempting to provide answers to all the questions raised.

Nitya Nanda, TERI, New Delhi

Foreign direct investment in natural resources: the global scenario

Purba Mukerji
University of San Francisco, USA

We have come full circle: an age-old impetus for colonization is now the latest trend in globalization. According to the *World Investment Report* published by UNCTAD (United Nations Conference on Trade and Development), an important manifestation of the integration of developing countries into the global economy is investment outflow into countries that own natural resources. Natural resources (like oil and gas, and metals) are surely required to fuel their growing economies. While this emerges as a new role for developing nations, in real terms it is just a continuation of an age-old tradition in which, hitherto, only developed nations participated.

A detailed sector-wise breakup of FDI (foreign direct investment) is available only for a very limited number of countries. We can attempt to get a rough proxy of the direction of capital flows by differentiating the receiving countries based upon their predominant sectors of specialization. Thus, one indication of the importance of investment in natural resources is that, in the current decade, FDI in countries that are primary exporters of petroleum has outstripped the growth in FDI in those that are primary exporters of manufacturing output (Figure 1). In Africa, the growth in FDI in resource-rich countries has been consistently positive for much of the current decade (Figure 2). In the Americas, however, the performance has been much less consistent. Policies regarding foreign investment in natural resources in this part of the world have become increasingly less welcoming. The movement towards nationalization of the oil and gas industry in Bolivia and Venezuela are prominent instances of this unfriendly policy environment.

Yet another indicator of the rising importance of natural resource investment is that the stock of FDI in countries that are primarily exporters of oil has been rising at an accelerated pace during the same time period (Figure 3). These findings mirror the inferences drawn by the *World Investment Report 2006*, which is based on a limited sample of countries for which detailed sector-wise breakups of investment is available. The findings indicate a decline in both services and manufacturing

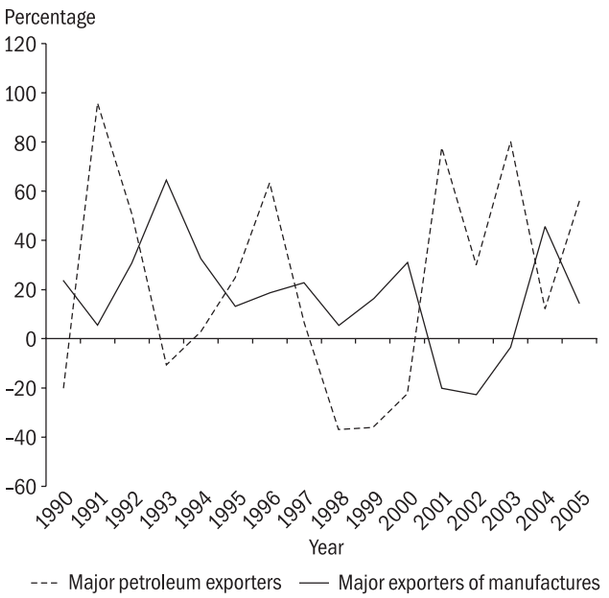

Figure 1 Growth rates of foreign direct investment flows

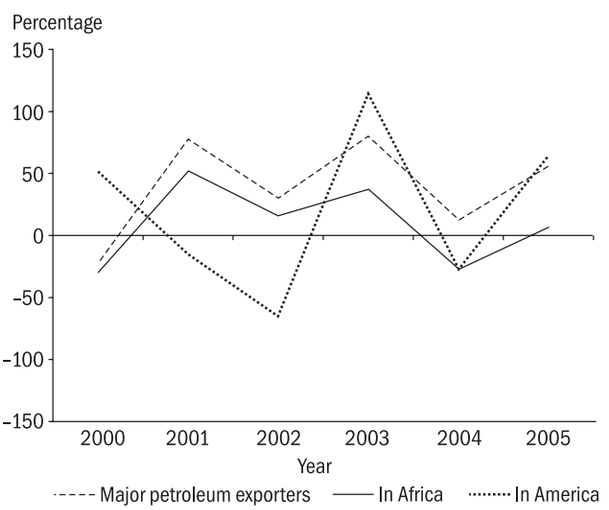

Figure 2 Growth rate of foreign direct investment flows

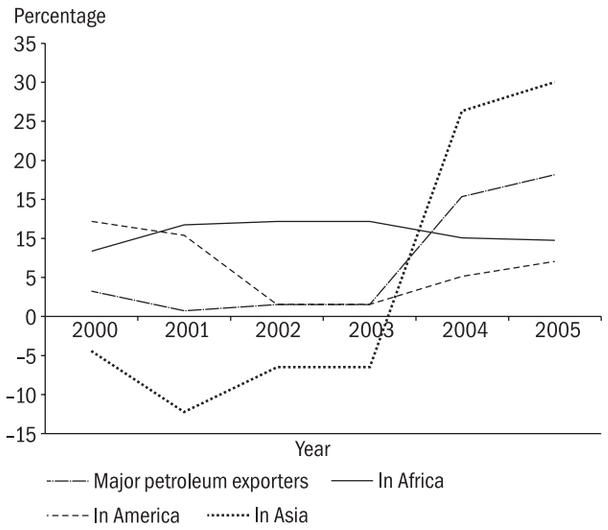

Figure 3 Growth rate of the stock of foreign direct investment flows

shares of FDI, and a rise in the primary resource sector's share. It is also interesting to note the predominance of natural resource producers among the top-performers in terms of the UNCTAD inward FDI performance index.[1] The country that ranked number one was Azerbaijan, mostly due to its large oil and gas industry.

Having established the significance of the flow of funds into natural resources, it is interesting to see if there are any indications of its future potential: is it likely to continue for a while, and if so, is there any concrete indication of it? Table 1 presents the II (internationalization index[2]) and the TNI (transnationality index[3]) of TNCs (transnational corporations) belonging to developed and developing countries. These are measures of the percentage of affiliates, assets, sales, and employment located abroad for these TNCs. A special feature of the FDI in resources originating from developing countries is that, for now, both the indices are well below those in developed country corporations (rows A and B in Table 1). This is in sharp contrast to the average of all industries taken together (row C), where these ratios though slightly lower in developing countries, are still quite close to developed country averages. This is not surprising given the relatively short history of TNCs originating in developing countries. It, however, does leave room for further investment, particularly in the resource sector, as the indices there catch up with the developed country averages.

Table 1 II and TNI 2004

	Industry	*Largest*		*TNCs from developing countries*	
Row	*TNCs*	II	TNI	II	TNI
A	Petroleum	61.2	53.9	25.2	32.3
B	Metals and metal products	77.1	63.7	39.9	29.5
C	All industries	65.9	56.8	49.9	50.7

II – internationalization index; TNI – transnational index; TNC – transnational corporation

Source World Investment Report 2006

As the fastest growing participants of the global economy, some developing countries are becoming important contributors of the FDI that many of the least developed countries are now receiving.[4] This trend has implications for countries at all levels of development. For rich countries, this signifies a new source of competition for natural resources that they seek, and a strong signal that the era of their unchallenged political and economic dominance might be at an end; for the developing countries making these investments signals their growing importance, and potentially bigger say in the international arena; and for the countries actually receiving these investments, it signifies an important source of funding for the development of their natural resource base, and the rest of their economy as well.

The impact of competition in natural resource investment on the political dynamics of international relations in several instances can be well observed. There is a regular trickle of rows, for example, those that arise between the US and the EU (European Union), and between Russia and its several erstwhile Soviet neighbours over FDI in resources. Austria-based energy company OMV AG decided to invest in lucrative Iranian gas fields this April despite opposition from the US. In another instance, a recent deal between China and Turkmenistan, which involves the former investing in and importing natural gas from the latter, represents a major step in the

[1] UNCTAD (United Nations Conference on Trade and Development) inward FDI (foreign direct investment) performance index is a measure of the extent to which a host country receives inward FDI relative to its economic size. It is calculated as the ratio of a country's share in global FDI inflows to its share in global GDP (gross domestic product).

[2] II (internationalization index) is the ratio of a TNC's (transnational corporation) foreign affiliates to total affiliates.

[3] TNI (transnational index) is a composite of three ratios – foreign assets/total assets, foreign sales/total sales, and foreign employment/total employment.

[4] Sales of TNCs (transnational corporations) originating from developing countries reached 1.9 trillion in 2005, and employed six million workers.

growing realignment of several of Russia's resource rich neighbours away from its sphere of influence.

In the context of the receiving countries, while increased competition for their resources helps to bring in more sources of finance at better terms than ever before, the ultimate impact on the rest of the economy, and on long-term growth prospects remain controversial. Empirical literature available in this field of study has found that resource-rich nations suffer from a 'resource curse'. That is, on an average, countries that have abundant natural resources tend to have lower economic growth rates than those that have relatively scarce resources. This trend had been noted by economists for a long time. However, the term 'resource curse' was first coined by Richard Auty (1993), whose study involved the first comprehensive and systematic work on the issue. However, the resource curse argument was strengthened, and got further impetus by the influential works of Sachs and Warner (1995, 2001). They put forth the argument that the main mechanism through which natural resource dependence leads to depressed growth is via its impact on the exchange rate. High demand for natural resources of a nation leads to high demand for its currency from foreigners who wish to buy these resources. High demand for the domestic currency leads to its appreciation, and this ultimately makes other non-resource tradable sectors of this economy uncompetitive in the world market. This phenomenon is commonly known as the 'Dutch disease'. Sachs and Warner found no significant impact of abundance of natural resources on the quality of institutions of a nation, and hence concluded that the Dutch disease was the primary reason why resource-rich countries lagged in growth.

Subsequent research, however, has yielded results that help us appreciate the fact that the impact of natural resource abundance may not be as clear-cut as once believed, and is in fact an amalgam of many interrelated processes, with several policy implications. Mehlum, Moene, and Torvik (2006) find that, while there may not be a direct impact of resource abundance on the quality of institutions, the latter do, however, determine the long-term growth outcomes of nations. According to them, when institutions are weak and grabber-friendly, precious productive resources are wasted on unproductive influence-seeking activities. This may result from a weak rule of law, malfunctioning bureaucracy, and corruption. In developing economies, where productive assets are already in short supply, this waste leads to negative outcomes. Thus, there is a threshold of institutional quality beyond which a country's resource abundance leads to positive outcomes for growth.

In a working paper of the IMF (International Monetary Fund), Arezki and Ploeg (2007) scrutinize the channels through which natural resources impact economic growth. Based on their cross-country study for the years between 1965 and 2000, they confirm the negative impact of natural resources on growth, and also the threshold effect of institutions as outlined above. In addition, they also find that the degree of openness of an economy has an important role in the sense that while poor institutions do lead to the resource curse, this impact can be somewhat ameliorated if trade policy is liberal The explanation provided for this causal relationship is that protective trade policies are sustained through subsidies, and that unproductive public sector investment is financed through resource revenues. This stifles competition and hinders the development of the economy's true comparative advantage by sheltering uncompetitive production.

The subject of the resource curse, and the way it must be fought is likely to grow in importance in the coming years, as the impact of natural-resource-seeking investment is felt worldwide. The past experience of various resource-rich nations can provide important policy lessons that ensure that this new wave of global integration has positive long-term outcomes for both the sources and the hosts of these investments.

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Outward foreign direct investment: has India arrived?

Nitya Nanda
TERI, New Delhi

Introduction

Like many other developing countries, India focused on attracting inward FDI (foreign direct investment) as one of the strategies for ensuring sustained high growth rate. But even as India was trying to become a major FDI destination, it suddenly found itself as an important origin of FDI flows (Singh 2007). With 136 outward investment deals, valued at $4.3 billion in 2005, the value of outward foreign investment by Indian firms almost neared the level of inward foreign investment. In 2007/08, the value of outward FDI is expected to exceed the level of inward FDI the country might receive.

To a large extent, competitive pressures arising from the economic reform process, particularly the liberalization of imports and inward FDI, might have been driving the Indian companies to invest abroad. The policy changes regarding outflow of capital from the country might have worked as a catalyst. The initial liberalization of Indian policy towards outward FDI started in the early 1990s, but significant steps in this direction were undertaken only in 1995. In 2004, the government finally removed the cap of $100 million on foreign investment by Indian companies and raised it to the net worth of the company (Kumar 2006).

Additionally, outward FDI is now actively encouraged by the government and is seen as a contributor to the growth process.[1] Therefore, it is quite likely that the current trend of outward FDI from India will continue. This, however, will mean that India may not depend much on FDI as a source of capital. This poses a new policy dilemma for the country—the challenge of striking a balance between the country's interest as a host country and its newly found interests as a home country (Singh 2007).

Against this backdrop, this article explores the phenomenon of Indian outward FDI flow by assessing its global importance, its structure and reach, major motives, and its possible future direction.

Much ado about something?

There has been much talk about Indian outward FDI not only in India but outside the country as well. There has, of course, been a major change in the size distribution of outward Indian FDI. While earlier they were in millions, recently Indian companies have bagged some high-profile multi-billion dollar deals. In particular, Tata Steel's acquisition of the British steel-maker Corus Group for $11.3 billion and Hindalco's acquisition of Canadian aluminum producer Novelis Inc. for $6 billion are drawing global attention. Mittal's acquisition of Arcelor also brought India into focus, though Mittal Steel is not an Indian company.

But if one keeps aside such euphoria over these big deals, India does not appear to be a major source of outward FDI. If one goes by the *World Investment Report 2006* prepared by UNCTAD (United Nations Conference on Trade and Development), India appears to be a laggard in terms of outward FDI even within the developing world. While outward FDI of developing and transition countries has been rising fast since the late 1990s, reaching up to $133 billion in 2005, the outward FDI stock of these countries stood at $1.4 trillion or 13% of the world total in 2005. India does not figure even in the top 15 of this list (UNCTAD 2006).

An indicator of outward FDI performance is the ratio of FDI to the size of the economy, which the *World Investment Report 2006* calls the outward FDI performance index. According to this index, India ranked 88th in the world. Developing countries like Malaysia, Panama, Bahrain, Azerbaijan, and Chile appear among the top 30, while Brazil and China rank 41 and 71, respectively.

The Indian outward FDI flow as a percentage of GFCF (gross fixed capital formation) was a mere 0.7%

[1] Speech by Ajay Dua, Secretary, Department of Industrial Policy and Promotion, at the 'National Conclave on Expansions and Consolidations towards Creating Globally Competitive Enterprises', organized by the Confederation of Indian Industry, 4 April 2007

in 2005 compared to a global average of 8.3%, and 9.5% and 5.1% for the developed and developing countries, respectively. Similarly, the Indian outward FDI stocks as a percentage of GDP (gross domestic product) were a meagre 1.2% in 2005 compared to a global average and developing world average of 23.9% and 12.8%, respectively (Table 1).

As per the *World Investment Report 2006,* Indian companies are yet to mark their global presence. In 2004, no Indian company figured in the list of top 100 non-finance companies ranked by foreign assets, and the ONGC (Oil and Natural Gas Corporation) was the only company in the list of top 100 non-finance companies from the developing world. With the recent acquisitions by Indian companies, a few more are likely to make it to the list of top 100 non-finance companies from the developing world, though it will take some time to make it to the global list of 100.

Outward FDI: trends and destinations

Indian outward FDI started picking up only in 2000 (Figure 1). Interestingly, this was the time when global FDI flows declined for a few consecutive years. Actual FDI outflow has generally been lower than approved outward FDI, but interestingly, in recent years, the former caught up with the latter, and in some years, even surpassed it.[2] This may partly be due to the fact that an approved FDI project takes time to materialize. It could also be due to the fact that the prospective investors are more serious about their FDI projects.

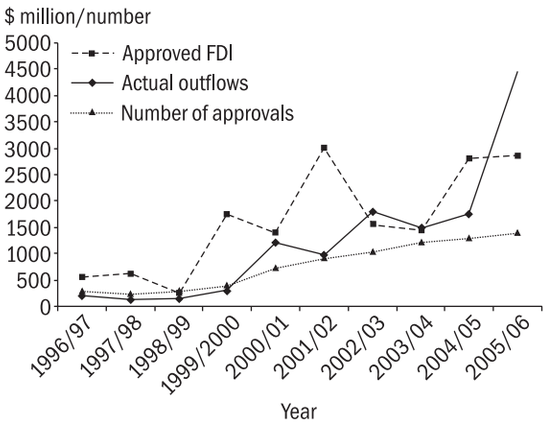

Figure 1 Trend in Indian outward foreign direct investment

Source Ministry of Finance (2007)

Though Indian outward FDI picked up from 2000, it made significant jumps in the last couple of years. Unfortunately, detailed breakups by sector and by country are not available for the recent years to understand the nature of Indian outward FDI. Moreover, the available breakups are for approved FDI rather than actual FDI outflows.

The total outward FDI stock of India was only about 0.4% of GDP in 2000, and moved up to 1.2% of GDP in 2005. This indicates that within just five years, Indian FDI outflows have been more than doubled that of the total FDI outflows up to 2000. The increase in Indian

Table 1 Indian foreign direct investment in the global context

		FDI flows as a percentage of GFCF			*FDI stocks as a percentage of GDP*		
		2003	2004	2005	1990	2000	2005
World	Inward	7.3	7.7	9.4	8.5	18.3	22.7
	Outward	7.4	9.3	8.3	8.6	20.6	23.9
Developed	Inward	6.4	6.3	8.0	8.2	16.2	21.4
countries	Outward	9.2	10.9	9.5	9.6	22.8	27.9
Developing	Inward	9.3	10.7	12.8	9.8	26.3	27.0
countries	Outward	1.6	4.8	5.1	4.3	13.4	12.8
India	Inward	3.4	3.1	3.5	0.5	3.8	5.8
	Outward	1.0	1.1	0.7	–	0.4	1.2

FDI – foreign direct investment; GFCF – gross fixed capital formation; GDP – gross domestic product

Source UNCTAD (2006)

[2] For investing abroad, the companies concerned need the approval of the government. Though companies apply for and receive approvals, they do not necessarily make the investment. Often, the actual investment made is lower than the approved amount, or the investment is made in a later year than the year in which the approval is received. Hence, actual FDI (foreign direct investment) is different from the approved FDI.

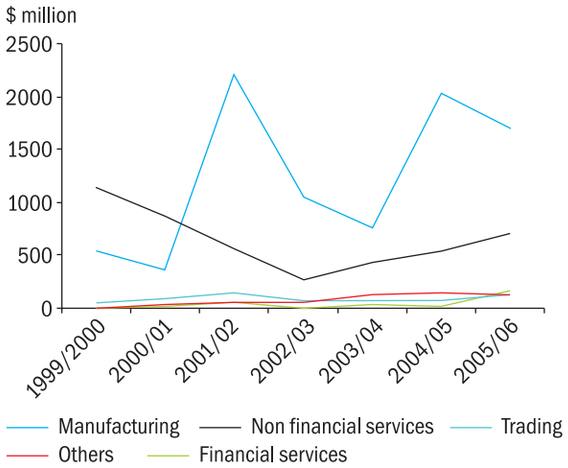

Figure 2 Foreign direct investment outflows in different sectors

Source Ministry of Finance (2007)

FDI outflows has been even more significant in recent years.

The outward FDI has traditionally been dominated by the manufacturing sector of the country. But in the 1990s, non-financial services sector, particularly IT (information technology), communication, and software services emerged as another important sector (Figure 2). In fact, during the period 1991–2001, the services sector as a whole accounted for about 59% of Indian outward FDI as compared to 39% from the manufacturing sector, mainly due to IT and communication services (Kumar 2006). It may be noted that since 2000, when the manufacturing sector re-emerged as the dominant sector, the Indian outward FDI has also picked up.

Though the breakups for the recent years are not available, all the mega deals have been in the manufacturing sector. It would, therefore, be safe to say that, overall, the manufacturing sector has been the driver of Indian outward FDI. This is against the overall global trend, wherein the services sector dominates the FDI scenario. There is another way in which Indian outward FDI flow differs from the global trend. Within the services sector, FDI in finance, insurance, and real estate occupies a major share (UNCTAD 2006), while the share of this sector in Indian FDI outflow is rather insignificant.

Within the manufacturing sector, the initial lead was taken by the pharmaceutical companies, which was considered only natural, as the Indian pharmaceutical industry is considered to be globally competitive. But the latest mega deals are all in metal industries like iron, steel, and aluminium. This is quite interesting, as Tata Steel, which

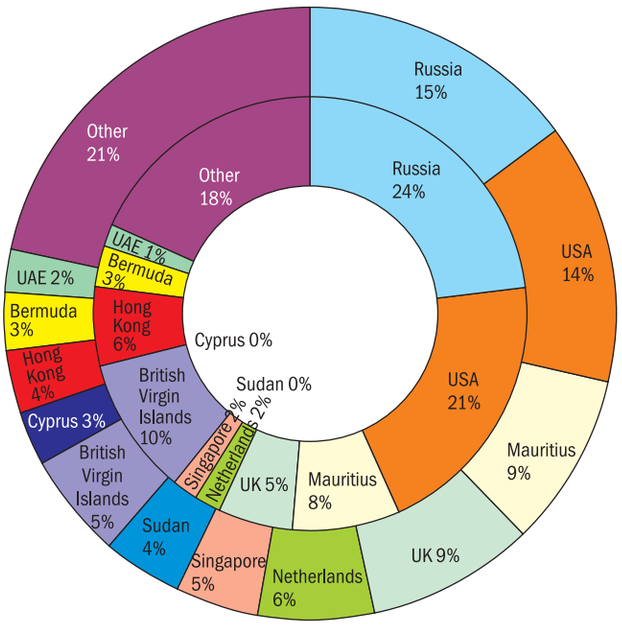

Figure 3 Destination of Indian foreign direct investment outflows: 1996–2002 and 2002–07

Inner circle: April 1996–March 2002; Outer circle: April 2002–October 2007

Source Ministry of Finance (2007)

was once written off because of its high costs, reinvented itself as one of the lowest-cost steelmakers in the world, and now has bagged the largest foreign acquisition deal made by an Indian company.

Destinations of FDI flows

There has also been a significant change in the composition of countries that are the destinations of Indian outward FDI. During the period 1975/90, about 86% of India's outward FDI went to other developing countries. The share of developing countries fell to just about 40% during the period 1991–2001 (Kumar 2006). This is against the global trend, as the FDIs from developing countries are generally not only destined to other developing countries, but are often within the region (UNCTAD 2006).

Interestingly, tax havens are also favourite destinations for many Indian companies. Mauritius, British Virgin Islands, Cyprus, and Bermuda are amongst the prominent tax havens that attract significant Indian FDI (Figure 3).

Just like their developed world counterparts, Southern transnationals are increasingly undertaking investments through acquisitions instead of investing in greenfield projects. The bulk of India's outward FDI is also in the form of mergers and acquisitions, mainly in

telecommunications, energy, pharmaceuticals, and more recently, in metals (Basu Das 2006).

Motives of Indian FDI

There are four main motives that influence investment decisions by TNCs (transnational corporations): market-seeking, efficiency-seeking, resource-seeking, and created-asset-seeking. Interestingly, most resource-seeking FDI is in developing countries and most created-asset-seeking FDI is in developed countries (UNCTAD 2006). This is because developing countries are endowed with more natural resources vis-à-vis their stage of development and access to technology and capital.

According to UNCTAD (2006), FDI in mining (including oil and other mining), which accounts for the bulk of the primary sector, has been largely responsible for recent growth in global FDI. Data on various forms of FDI by sector – especially cross-border mergers and acquisitions (M&As) – shows that in 2005, the primary sector gained importance in terms of both target and acquiring industries, while both manufacturing and services sectors deteriorated, though services remained the dominant sector in cross-border investment. Resource-seeking seems to be the dominant motive in the global spurt in FDI.

In the case of the Indian companies, however, the need to pursue customers for niche products and the lack of international linkages are key drivers of internationalization (UNCTAD 2006). Indian firms have also been enticed by supportive host-government regulations and incentives, as well as favourable competition and inward FDI policies. Also, considering that Indian outward FDI is predominantly in the manufacturing sector of developed countries, it seems that it is influenced by the market-seeking motive.

Indian outward FDI in the developed world, though primarily market-seeking in motive, contains an interesting dimension to it particularly in the pharmaceuticals and IT sector. One important factor in this connection has been to jump the regulatory barriers. In case of pharmaceuticals, it is difficult to get approval for drugs without local presence. Similarly, for export of IT services, it is often necessary for professionals to work on-site and move from time to time, although individual professionals find it difficult to do so. As per GATS (General Agreement on Trade in Services) commitments, countries allow intra-corporate transfers of personnel only. Therefore, it becomes necessary to open local branches or subsidiaries.

Indian oil companies are acquiring overseas oil and gas assets and have established a presence in a number of countries such as Nigeria, Russia, Sudan, Libya, Egypt, Qatar, Ivory Coast, Vietnam, Myanmar, Cuba, and more recently in Brazil. There has been investment in coal and iron ore. Jindal Steel's $2.1-billion project in Bolivia involves the setting up of an integrated steel plant and development of an iron-ore mine in Bolivia. Separate breakups for data on FDI in minerals or mineral-based industries are not available, but the category of 'others', which include these industries, has shown some increase. The emergence of Sudan as an important destination of Indian FDI probably indicates that resource-seeking investment is also gaining ground. It is, however, interesting to note that despite recent investment in oil and gas, the importance of Russia as an investment destination has declined.

Some recent foreign investment deals by Indian companies are in resource-intensive industries. However, that does not necessarily mean that resource-seeking is the primary motive. For example, the main justifications given by Tata Steel for the purchase of Corus Steel of the UK have been (1) synergy, (2) access to markets, (3) access to technology, and (4) economies of scale. In fact, Tata Steel had to hunt for access to more coal as a result of acquisition of Corus Steel, and recently bought a coal stake in Mozambique.

It is often argued that the motivations behind cross-border investments by Southern TNCs are not different from others. It is also true that majority of South–South FDI flows are concentrated in infrastructure and extractive sectors such as oil and gas (UNCTAD 2006). However, traditionally, Indian FDI seems to have been driven primarily by market-seeking motive. Though it appears that created-asset-seeking , resource-seeking and, to a much lesser extent, efficiency-seeking motives are also receiving prominence.

Conclusion

Despite the headlines on the overseas foray of Indian companies, India is still a small player globally, in terms of absolute volumes of FDI, size of Indian companies, and sectors targeted. The coverage of sectors or industries is however expanding. Indian investment is, of course, quite widespread in terms of countries where Indian companies are active. It is, however, quite interesting to note that while much of FDI from other developing countries is motivated by resource-seeking objective, it is not the primary motive for Indian FDI outflows.

India has companies that are small in size but are globally competitive, particularly in sectors such as software and IT services, pharmaceuticals, automotives, and metallurgy. There are also companies that may not yet have a global presence but are globally competitive (Ram Mohan 2006). One would, therefore, see a strong resolve from some of these companies to make their presence felt globally. Indian companies may find it extremely difficult to achieve the kind of progress required in becoming globally important through 'organic growth', and hence would like to go for mergers and acquisitions, and foreign companies increasingly will become their targets. Thus, more FDI outflow can be expected from India. But if organic growth of that sort is difficult, managing growth through mergers and acquisitions is not easy either. Not only that, majority of the mergers and acquisitions do not enhance shareholder value at the acquiring firm, and some of them simply fail, AOL (America Online) TimeWarner being a classic example (Witzel 2004).

It is, therefore, unlikely that the Indian companies will have unhindered success in acquiring foreign firms. Since these Indian companies are acquiring companies in developed countries, managing a cultural difference – perceived and real – will pose a big challenge for them. The outcomes of high profile acquisitions like Tata's Corus will have a significant bearing on the future requirements of Indian companies for foreign acquisition.

Indian companies might get encouraged to go for acquisition in foreign lands by the appreciating rupee, which, as all indications suggest, is likely to continue. This will make foreign assets cheaper for Indian companies, in turn making foreign acquisition that much easier.

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Foreign direct investment and South–South economic engagement

Ermias Tekeste Biadgleng
Innovation and Access to Knowledge Programme, South Centre, Geneva

The South is facing a significantly altered global economy due to the changed role of multilateral and regional organizations, resulting in changes in the regulatory functions of national governments as well. This has also transformed the business model, strategies, and asset structure of corporations. The role of the South in the global economy has also changed, largely driven by the successful economic development of some countries[1] and the continued critical role of oil-exporting countries. At the same time, there are crisis-ridden states[2] and others, which have a limited role in the global economy. They are 'inconsequential' to the global economy and adversely affected by global inequality. This has further influenced the role of the South.

FDI (foreign direct investment) primarily involves the establishment of subsidiaries by multinational corporations, the acquisition of lasting and significant economic interest in local corporations or mergers among corporations located in different jurisdictions, and the establishment of new enterprises by foreign entrepreneurs or between a foreign and domestic partner (joint ventures). This basically excludes the sales office of foreign companies, for example, airline ticket office; commercial presence for mere supply of services and goods that are processed elsewhere; and most importantly, passive holding of stocks, bonds, and other financial assets. FDI flows represent only a limited aspect of global economic relationships. Trade, financial transactions, and new models of business such as outsourcing of services and components of R&D (research and development) form other important aspects of the current global economic relationships. FDI is essentially undertaken by transnational corporations, and often their activities in the host countries are not integrated with the local economy. Companies operating logging concessions and exploitation of crude oil for the export market may have limited contribution to economic diversification and value addition from their operations. International transactions involving the outsourcing of R&D could be more valuable in terms of contribution to technological development than oil concessions.[3] As a result, discussion on FDI is not necessarily about important economic relationships for development.

A useful indicator for measuring and analysing capital movements is FDI data. Countries differ in their practice of accounting, monitoring, and valuation of FDI flows. For developing countries, a clear understanding of how FDI data is compiled and interpreted could be important for assessing the contribution or impact of FDI and specific FDI projects on the national economy. A general trend in reporting the increase in FDI flows by international organizations would not help to get an exact picture of FDI in each country and sector. Ultimately, policies formulated must be based on analysis and evaluation at national level, especially to avoid generalization about the nature, quality, and contribution or impact of FDI. There is also a need to avoid generalization about the determinants of FDI flows, usually explained as consisting of market size, quality of infrastructure, human resource, and natural resources, since the relevance of the factors varies from country to country and from time to time. A review of the trends and nature of South–South FDI based on the *World Investment Report* of UNCTAD (United Nations Conference on Trade and Development), the *World Finance and Development Report* of the World Bank, and the *African Foreign Investor Survey 2005* of UNIDO (United Nations Industrial Development Organization) and other sources follows.

[1] In addition to the four Asian tigers, namely, South Korea, Singapore, Hong Kong (China), and Taiwan province of China, countries such as Argentina, Brazil, Botswana, Chile, China, India, South Africa, Malaysia, and Egypt have maintained a sustained growth and achieved significant poverty reduction during the 1990s.

[2] Somalia, Afghanistan, and Iraq are among the most cited as 'failed states' (see **The failed states index 2007**, *Foreign Policy*, July/August 2007 issue)

[3] Under bilateral investment agreements, FDI (foreign direct investment) consists of any asset irrespective of the nature of operation of the investment.

Diverse facets of South-South FDI

The *World Investment Report 2006* of UNCTAD and the *Global Development Finance 2006* of the World Bank on the global flow of FDI generally show positive trends and increase in total net flows to developing countries. Ironically, in 2005 around 59% of the total FDI inflows went into developed countries (UNCTAD 2006, p.xxii).

The outward FDI from the developed countries to the South has been concentrated in a limited number of developing countries (World Bank 2006, p.43). Brazil, China, Hong Kong (China), Mexico, and Singapore have been the five largest host-developing economies since 1996 (UNCTAD 2006, p.5). Countries such as Chile, Argentina, South Africa, Egypt, India, Chinese Taipei, and Malaysia continue to maintain a significant share of the remaining FDI flows to developing countries. The discussion and various reports on FDI often overestimate the total resource flows from developed to developing countries. The total flow of capital and resources from developing countries could simply offset all the gains from FDI, if trade balance, brain drain, repatriation of revenues from operation of transnational corporations, debt services, recurring franchise, royalty and other payments related to intellectual property rights, and savings in foreign accounts are taken into consideration.

With all the difficulties of determining what amounts to FDI and the statistical problems, the South–South flow of FDI is reported to have shown a steady increase from an estimated $14 billion in 1995 to $47 billion in 2003.[4] A bulk of this inflow has been among the Asian countries (UNCTAD 2006, p.117). Significant amount of the outward investment flows from the South comes from the same group of countries that are relatively successful in economic development and are the major destinations of FDI flows from the developed countries. Hong Kong (China), Singapore, Taiwan province of China, Brazil, China, Malaysia, South Africa, Republic of Korea, Mexico, Argentina, Chile, and Indonesia received the lion's share of the total flows of FDI from developing countries in 2005 (UNCTAD 2006, p.113).

Asia has become an important player in intra-South investment flows. Intra-South FDI inflow has been primarily from Asia to Africa. Malaysia has emerged as a significant new source of FDI in South Africa, whereas almost half of China's outward FDI in 2004 went to the primary sector in Latin America (World Bank 2006, p.126). While data on the sectoral composition of the total intra-South FDI is not available, it is still quite clear that a substantial amount of the investment is attracted in particular to the services, infrastructure, and mining sectors.

Different perceptions on risks

The perception of investors from the South substantially differs from that of their counterparts in the North with respect to investment opportunities and risks in developing countries. The *UNIDO Africa Foreign Investor Survey 2005* found that investors from the South are less pessimistic about the trends in the investment climate in Africa. In contrast, the European investors perceived deterioration in the investment climate. In addition,

- South African investors perceived considerable improvements in market conditions while European investors perceived only slight improvements.
- The change in political stability, availability of skilled labour, key clients, physical security, quality of life, and economic stability was rated by some South

Table 1 South–South FDI as a share of global FDI (1999–2003)

FDI	1995	1999	2000	2001	2002	2003e
Total inflows (1) ($ billion)	90.3	163.5	154.7	159.3	135.3	129.6
From high income OECD (2) ($ billion)	48.1	95.4	93.7	84.8	55.1	59.4
From high-income non-OECD (3) ($ billion)	28.2	35.0	22.7	24.8	27.2	22.8
South–South FDI (1)-(2)–(3) ($ billion)	14.0	33.1	38.3	49.7	53.0	47.4
South–South FDI (%)	15.5	20.2	24.8	31.2	39.2	36.6

FDI – foreign direct investment; OECD – Organisation for Economic Co-operation and Development; e – estimate.

Note The South–South estimates are based on 35 countries that account for 85% of total FDI flows to developing countries. The estimates are based on the World Bank's classification of developing countries.

Source World Bank staff estimates

[4] UNCTAD (United Nations Conference on Trade and Development) provides the data up to 2005. However, the UNCTAD data includes FDI from and to the transition economies (UNCTAD 2006, p. 105).

groups as considerably improved while Europeans rated it as somewhat deteriorated.[5]

Intra-South FDI as source of finance for the poorest countries of the world

Due to the difference in perceptions of risk and assessment of investment opportunities, and other factors for investment decisions, intra-South FDI has emerged as one of the main source of finance for the LDCs (least developed countries). Intra-South FDI accounted for over 40% of the total inflow of FDI to these countries. Investment from South Africa accounted for more than 50% of the total FDI flow to Lesotho, Malawi, the Democratic Republic of Congo, and Swaziland (UNCTAD 2006, p.112). The proportion of North and South investors in sub-Saharan Africa is almost equal, representing 54% from the North and 46% from the South (UNIDO 2006, p. ix). Due to the difference in perception of the factors for investment, investors from the South would tend to continue investing and expanding more significantly in other developing countries.

The regional dimension of intra-South FDI

Intra-South FDI flows show strong intra-regional trends. South Africa's outward investment, for instance, has been largely towards other countries in the southern African region. Intra-regional flows within Africa were estimated at $2 billion, reflecting in particular, South African FDI to the rest of the continent (UNCTAD 2006, p. 21). Similarly, during the period 2002–04, average annual intra-Asian flows amounted to an estimated $48 billion. This was more than four-fifths of all intra-South FDI for the period (UNCTAD 2006, p.117). The second largest regional flow of FDI was among Latin American countries. This was led by investors from Argentina, Brazil, and Mexico, but in a limited range of economic activities (ECLAC 2006, p. 81). As a result, intra-South FDI flows serve as an important indicator to demonstrate the influence FDI flows have on regional economic relations in the South.

Intra-South FDI and local economy

Although investment from developing countries is flowing to the least developed ones, it would be premature to conclude on the contribution of intra-South FDI to economic development. Intra-South FDI, as a recent phenomenon, is yet to show its impact on the development of the local economy, the use of local content, training and upgrading of local skills, and technology transfer. Theoretically, investors from developing countries could have technologies that can be easily absorbed by the local actors. They are also expected to show a tendency to use less capital goods and more labour for production of goods and services. Less sophisticated companies from the developing world potentially provide better opportunity for upgrading local capacity (World Bank 2006, p.117).

FDI from China to Africa is largely, but not exclusively, in the mining sector. India has invested in mining, financial, food processing, and light manufacturing sectors; most notably in Mauritius (Broadman 2006). Both Brazilian and Argentinian investment in Latin America has been in the primary sector (ECLAC 2006, p.15).

Additional research is needed to ascertain if the terms of concession or production-sharing arrangements for the exploration of mineral resources by developing country investors are different from the companies of the rich countries, and favourable for the local economy. Evidently, the multiplier effect of FDI in the mining sector tends to be very limited compared to investment in the manufacturing sector.[6] The UNCTAD 2007 report on LDCs ascertained that there is limited evidence to support the presence of multilateral corporations in the mining sector leading to technological upgrading. On the contrary, mineral extraction activities in LDCs are capital-intensive; have little impact on employment; result in export of unprocessed raw materials; and a large share of foreign exchange earnings is retained abroad. In other words, mining operations are weakly embedded in domestic economies, as they have few forward and backward linkages in their host economies (UNCTAD 2007, pp.35–36). Intra-South investment in the mining sector would create the same imbalance, unless designed as joint venture operations with arrangements to build local capacity, and retain earning domestically.

The UNIDO survey indicates that the origin of investors has little importance as a determining factor for the use of local input. Intra-South FDI as a recent phenomenon and modest in size may not contribute to the use of local supplies in the immediate short term. Similarly, the linkage with local firms through sub-contracting and retention of services primarily depend

[5] The survey covered 15 sub-Saharan African countries: Burkina Faso, Cameroon, Côte d'Ivoire, Mali, Senegal, Ethiopia, Ghana, Guinea, Kenya, Madagascar, Malawi, Mozambique, Nigeria, Uganda, and Tanzania (UNIDO 2006).

[6] The multiplier effect of FDI (foreign direct investment) is the amount of additional income that one FDI dollar can generate in the host economy.

on the sector of investment, and the level of industrialization of the host economy, rather than the origin of the companies. The survey indicated the performance of southern companies in training and upgrading of local skills as a mixed bag. However, companies from South Africa invest more on training and upgrading of skills than the rest of the surveyed investors from the South (UNIDO 2006, p.92).

Intra-South FDI is playing a critical role in the textile industry where there are preferential arrangements extended by the developed countries. Almost 61% of the FDI in the garment industry in Cambodia originated from China, Taiwan, and Hong Kong (China) in the period 2000–05. This led to the expansion of exports from Cambodia under the GSP (generalized system of preferences) in 2004. According to the UNCTAD (United Nations Conference on Trade and Development) report on LDCs, the impact has been dramatic, with the industry accounting for 72% of manufacturing value added and 15% of GDP in 2004 (UNCTAD 2007, p. 37). The opportunity presented to Cambodia in terms of access to marketing channels in the garment industry is enormous. However, the same report shows that for Cambodia, Lao, Bangladesh, and Myanmar, equipment and machinery used in their economies have either been relocated after use in China, Malaysia, and Thailand or imported second-hand by domestic producers. None of them seem to be equipping themselves effectively to sustain expansion in the garment industry once the preferential access instruments are removed (UNCTAD 2007, p.40).

Since countries in developing countries compete in the same sector with similar level of value chain, intra-South FDI is vulnerable to even minor changes in factors that influence decision-making by investors. The erosion of preferential arrangements in access to the developed country markets, changes in exchange rates, and other factors that diminish the marginal difference in the cost of production could trigger a decline in further investment or even the relocation of investment back to the home country.

South companies in infrastructure development

Intra-South economic relationships are also adding a new dimension to infrastructure projects and the role of China and India in Africa. Infrastructure projects are largely services rendered for governments under competitive bid procedures. Some arrangements of infrastructure development such as the BOT (build, operate, and transfer) take the form of franchise, and involve private financing and concessions for operation of the project for a specific duration on the expiry of which the ownership gets transferred to the public institutions. In developing countries, debts and grants by donor governments and international financial institutions form important means of financing infrastructure projects.

The contribution of South companies to the development and rebuilding of infrastructure in other developing countries is considerably high. The Centre for Chinese Studies at the Stellenbosch University of South Africa conducted a study on infrastructure projects undertaken by Chinese companies in Angola, Sierra Leone, Tanzania, and Zambia. The study revealed that the success of China's companies, particularly SOEs (state-owned enterprises), could be attributed to cost competitiveness in overall bidding price, access to cheap capital through Chinese state-owned banks, access to skilled low-cost labour, access to cheap building materials through supply chains from China, and political support from the Chinese government. The companies were found to be rarely competing with indigenous construction companies due to their specialization in large-scale construction projects. Also, they employed large numbers of local labour. However, the Chinese companies have shown only limited interest in collaborative ventures with local construction companies due to their low levels of human capital, technological proficiency, and problems related with finance and management. Instead, they found foreign firms as preferred partners for joint ventures and subcontracts. The study also revealed that the quality of services depended on quality controls (Centre for Chinese Studies 2007).

What does South–South FDI mean for developing countries?

The recent phenomena of intra-South FDI and participation in infrastructure projects demonstrate that the southern countries have been able to discover their respective potential and need in real economic terms, going beyond political rhetoric. Although the contribution of intra-South FDI to economic development is not yet clear, there are certain critical areas that need particular focus at this stage.

- FDI in minerals and energy sector from developing countries and the economic interest of host developing countries;
- Regional flow of FDI and regional economic integration in the context of the current global economic relationships
- Least-developed countries, infrastructure development, and intra-South financing of projects

The intra-South FDI flows illustrate the role the mining sector plays as the main force behind strengthening political and economic relationships among developing countries.

Cooperation in energy sector has been the basis for regional economic integration, at least in the European Union. Regional investments in Latin America, led by companies from Brazil, Argentina, and Mexico in the oil and gas, steel, and cement sectors have enhanced the interdependence of the Latin American countries, and have contributed to an increasing economic and political interaction (ECLAC 2006, pp.110–111). The emergence of intra-South FDI in the mining sector is accompanied by the reinforcement of political questions on benefit-sharing from the utilization of resources by local communities and national governments,[7] the increase in demand by developing countries and increase in price of commodities, and the continued legacy of oil exploitation by multinational corporations, which seriously undermine the public opinion towards FDI. Accounting for all these factors would mean that if countries such as China, India, and Brazil wish to establish sustainable economic relationships with resource-rich developing countries, they must change the method of doing business. It involves questions of equity, the future of the host developing country, and communities in the region that supply such resources.

Moreover, intra-South FDI has been largely within regions and sub-regions, indicating that cooperation has become critical at regional level. Cooperation on FDI has been understood largely in terms of bilateral and regional investment agreements. However, the most important contribution should be made from infrastructure development, facilitation of regional financial transactions, and the regulation of company formation, operation, and dissolution. Important regulatory aspects of regional investment flows can be better achieved under community or regional laws on business organizations and commerce than under investment agreements.

Although FDI from developing countries has become an important source of finance in LDCs, capital-exporting developing countries should be able to make available, at the minimum, the same incentives that are available for investment in oil and gas. However, SOEs, especially those of China that have become competitive in securing the projects, should be evaluated in order to ensure an increase in employment, transfer of technology, know-how, and managerial skills from their operations.

Conclusion

The economic development of a number of developing countries is primarily responsible for the contemporary trend of increasing economic engagement between them. An increase in the inflow of FDI from developing countries is a recent phenomenon. At this stage, its impact on the local economy and contribution towards development may not be readily observable. However, there are key issues emerging from intra-South FDI. Developing countries would benefit from a critical examination of FDI and the development needs of host countries.

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[7] The governments of Venezuela and Bolivia have shown their interest in enhancing their share in the oil and gas sector of their respective economies, while tension between the World Bank and the government of Chad; the problems in oil-producing regions of Nigeria; the challenges of oil-revenue sharing between the southern region of Sudan and the central government; conflicts between the regions and communities in Iraq; as well as the UN Security Council's efforts on the problems in the Darfur region of Sudan show the complexity of the political issues.

Book review

International investment and sustainability

Anandajit Goswami
TERI, New Delhi[1]

Book review of *International Investment for Sustainable Development: Balancing Rights and Reward*, edited by Lyuba Zarsky, published by Earthscan in UK and USA (2005)
ISBN – 1-84407-039-5 (paperback)/1-84407-038-7 (hardback), 226 pp.

This book contains eight chapters dealing with the dimensions of FDI (foreign direct investment) and sustainable development. The first chapter, by Kevin P Gallagher and Lyuba Zarsky, analyses the positive, neutral, and negative impacts of FDI on economic growth, efficiency, spillovers, and environmental performance of developing countries with the help of a case study of Mexico during the 1990s. The spillovers of clean technologies from FDI were minimal in Mexico at that time. There was a need for a national policy framework for the promotion of endogenous local capacities for sustainable production. The mainstream theory suggests that FDI is facilitated by imperfections in markets for goods and factors of production like labour, capital, and technology. The FDI flows could take place in a host country when there is a chance of earning rent by investing in that country. The FDI flows could also be driven from a home country to a host country by push factors like government restrictions on investments in the home country. In such instances, FDI could be directed to other destinations, in order to acquire larger market access, and might not always contribute to sustainability of the host country. Research shows that FDI has been mostly concentrated on large developing countries and primary sectors over the years. FDI could contribute to sustainability through efficiency spillover when it

- helps the local suppliers to set up production facilities and hence contributes to local employment, and
- helps in developing capacity for product and process innovation.

However, these spillovers would also depend on the host country's firm, government, and industrial policies. In many cases, FDI could negatively impact the sustainable development of a country by crowding out the investment through increase in interest rates and cost of capital for business. Crowding out of investment could also occur if the employed workers in the production process invest in imported goods and services. The environmental impact of FDI on sustainability depends on (1) environmental performance of TNCs (transnational corporations), (2) impact of FDI on the scale and composition of production, and (3) impact on national and global environmental regulation.

These impacts would depend on the type of technology, environmental management system, environmental criteria posed on suppliers, and subcontractors. Impacts of FDI on sustainability could be illustrated by an example of Mexico where FDI was directed mostly to the manufacturing sector. FDI in Mexico contributed to crowding out of investments through an increase in the cost of capital. This had an impact on the balance of payments of Mexico through an appreciation of the exchange rate and overvaluation of currency. Moreover, there was a decline in environmental expenditure by 45% after 1993 following FDI. Job creation through FDI in the manufacturing sector was only 12% of the total employment available. This had an impact on the inequality and sustainable development of the country through a rise of 15% in the income share of 10% of the richest population followed by a drop of 1.7% in the income share of 10% of the poorest population. This chapter does not deal with the issues of how an incentive framework, facilitated by FDI and a policy integrating environmental management, could push an FDI recipient country towards a sustainable pathway.

The second chapter, by Monica Araya, elucidates how FDI could increase sustainable development in the host

[1] Research Associate, Centre for Global Agreement, Legislations and Trade, Resources and Global Security Division

country with increasing infrastructure development, technology transfer, and capacity building. It does not highlight the mechanism of creating technology transfer and capacity building in a host country receiving FDI. This chapter argues that FDI could contribute to sustainable development through environmentally benign investments, in comparison to portfolio equity investment, due to the following reasons.

- Low environmental accountability of portfolio investments with high transaction costs of information acquisition.
- Short-term profitability objective of portfolio investments work against attainment of environmental efficiency objectives.
- Studies show that FDI from a home country is often driven by a push factor explained by the 'pollution-haven' hypothesis and a pull factor from a host country explained by the 'race-to-the-bottom' hypothesis. Environmental impacts of FDI depend on technology of production activities in host countries. The usage of clean technology in host countries, in turn, depends on the availability of debt financing and its impact on the scale of production and demand for raw materials, energy, water, and pollution.

In this regard, the linkage between the 'Kuznets Curve' hypothesis FDI, and willingness to pay for a technology of higher environmental quality in these countries is of significant importance. However, increase in environmental quality could also take place if local firms are incentivized to adopt clean technologies through voluntary market-based approaches of regulation. Environmental practices of firms depend on market orientation, public scrutiny, and corporate strategies of the firms investing in the home country. An environmental impact of a technology transfer through FDI would depend on the availability of local capabilities and training. A structural shift of FDI from the manufacturing sector to the service sector also contributes towards environmental impact and sustainable development of the host countries. However, the environmental impact of FDI through technology transfer would be the resultant net effect of negative scale effect, and positive technological and structural effect. The other factors, that contribute towards environmental impacts from FDI are (1) market structure, (2) market demand for environmentally benign products, (3) corporate guidelines of donor agencies, (4) shareholder pressure for clean environmental practices, and (5) the brand value of the TNCs (transnational corporations) investing in the host country.

The third chapter, by John Mugabe, explores the linkages between quality of FDI and sustainable development through poverty reduction. This would depend on livelihood options, labour and social rights, national economic development, and institutional policies, integrating environmental and poverty reduction considerations into the FDI policies, laws, and practices. This has not happened in many sub-Saharan African countries, which resulted in low per capita income, increase in debt, and decrease in the capacity of servicing the loans in these countries. Conflicts have increased in these countries in the post-FDI regime. More than 50% of FDI during the 1990s has gone into natural resource sectors like gold mining. In Nigeria, more than 90% of the FDI has been directed to petroleum and natural gas sectors. Nigeria has a law allowing free repatriation of foreign currency, dividends, and capital transfers from FDI. The FDI in natural resource sector, in certain countries like Angola, has been backed by legislations. In Botswana, FDI has taken place through institutional clearances from the BEDIA (Botswana Export Development and Investment Authority). Botswana has a mining law laying down guidelines for investments in diamond mining, whereas Ghana has a law requiring environmental permits for FDI. Regional trade and investment treaties have facilitated FDI in many East African countries through the establishment of the EAC (East African Community). On the whole, FDI has failed to contribute to sustainable development of these countries due to (1) lack of policy coherence, (2) poor institutional coordination, and (3) poor linkage between FDI and poverty reduction. In this regard, the role of a holistic environmental policy in creating such linkages – between FDI and sustainable development of these countries – could also have been dealt with in order to give a broader perspective to the issue.

Simon S C Tay and Iris Tan, in the fourth chapter, discuss the emerging paradigm of FDI and sustainable development in Asia. Anecdotal evidence shows that countries like Singapore have been able to generate economic growth through FDIs concerning environmental protection. Such FDIs are achieved on account of better legislative and governance practices. The process, however, has slowed down due to corruption cases and the East Asian financial crisis, which resulted in reduced availability of funds. Countries like China, Japan, and South Korea have agreed to monitor air pollution by integrating trade, investment, and environmental needs. This would require a proactive role through civil society initiatives like the CCIED (China

Council for Environment and Development) initiative in China, Friends of the Earth initiative in Malaysia, and many others. Local governance regimes, like those in Taiwan and South Korea, also play a significant role. Religion in Indonesia was the key in creating a public perception in favour of the environmentally sensitive FDI. In Indonesia, Roman Catholicism motivated the FDIs that were linked with objectives of sustainability. A change in the mindset of the corporates also contributed in raising economic productivity through FDIs by balancing environmental needs. Larger interactions through Internet awareness programmes have played a key role in changing these perceptions. The chapter does not deal with the 'creation of a market demand for environmental goods' in these countries.

The fifth chapter, by Luke Eric Peterson, deals with governance of international investment. It observes that BITs (bilateral investment treaties) have been more successful than multilateral agreements. BITs have often lacked transparency and procedural rules for investments. The BITs have been signed largely between the North and the South, with investor protection in the form of the MFN (most favoured nation) treatment. Some of the provisions of BITs are dependent on the pre-establishment phase instead of post-establishment phase of investments. The governance structure of settling investment disputes in the BIT need involvement of institutions like the ICC (International Chamber of Commerce), the UNCITRAL (United Nations Commission on International Trade Law), and others. The institutions dealing with the BITs generally deal with a variety of commercial disputes. There is no compilation of precise information regarding cases arising from such investment treaties. Often, there are multiple arbitrations dealing with the same issue resulting in reduced transparency, which has an impact on the sustainable development of the countries engaged in the treaty. Publication of documents related to investment arbitrations could be one of the ways to attain transparency. However, this could be controversial in case of investments that have sensitive health, safety, and environmental implications. In many cases, the lack of binding rules on investment has skewed the governance framework. The unique nature of arbitration has often led to repeated litigation raising the governance costs. Multiple arbitrations could lead to scrutiny of sustainable development measures, linked to investments by many tribunals, thereby raising the governance costs. Selection of arbitration rules, by the investors, could impact the review process and transparency of decision-making among the parties in a BIT. This chapter creates the scope of future analysis by creating a 'green court' or 'green bench' in settling bilateral investment disputes.

Chapter 6, by Aaron Cosbey, deals with the details of Chapter 11 of NAFTA (North American Free Trade Agreement). The provisions of Chapter 11 lay emphasis on protection of investors, who impact the regulatory capacity for environmental management, by allowing private parties to start direct arbitration unlike the state-to-state disputes of the WTO (World Trade Organization). The agreement allows each litigant to select any one of the arbitrators, for example, the ICSID (International Centre for Settlement of Investment Disputes), ICSID Additional Facility, and the UNCITRAL. Chapter 11 of NAFTA contains provisions like (a) protection from direct or indirect expropriation, (b) national treatment and MFN obligations, and (c) performance requirements, minimum international standards of treatment obligations. Direct appropriation is easier than indirect appropriation and it has impacted the investors by creating tax burdens. Investment regulation in NAFTA is often related to the economic value of investment and has also taken environmental considerations while violating the MFN principles of investments. For instance, Metalclad was disallowed from setting up a waste-processing facility in Mexico on grounds that the land was meant for protection of the cactus species. The chapter, however, does not address the issue of impact assessment of such interventions.

Chapters 7 and 8, by Konrad von Moltke and Sandy Buffett, highlight non-discrimination and corporate governance principles of investment regimes. These chapters elucidate the linkages between non-discrimination in investment regimes and the nature of institutions. Discriminatory investment regimes could promote sustainable development by balancing private rights of investors and the promotion of public good. Investments guided by cross-border environmental management have contributed in promoting sustainable development. Non-discrimination in investment regimes could be brought about by technological preferences, governed by voluntary and local governance mechanisms. Thus, an international governance framework has to imbibe transparency, accountability, and legitimacy in the local governance. The governance framework could also have a global framework agreement on investment, with the implementation clause being left to subsequent agreement protocols. In this regard, many of the regional trade agreements, like NAFTA, have been framed from other secretariats hinging on the independence of trade

agreements. Thus, a further scope of analysis lies in how to create such independence in trade agreements.

Chapter 8 focuses on the importance of corporate governance and information disclosure as an important tool of attaining minimum corporate, environmental, and social standards in an investment regime dominated by TNC investments. This chapter highlights the point of transparency to shareholders in Sarbanes–Oxley Act of 2002 of the US. It further establishes the impact of accountability and transparency of corporates on the nature of investments of the TNCs. The chapter attempts to define the OECD (Organisation for Economic Co-operation and Development) principles of corporate governance (fairness, transparency, accountability and responsibility) through the following indicators.

- equitable treatment of shareholders (fairness)
- accurate disclosure of information (transparency)
- strategic guidance (accountability)
- stakeholder right recognition with a cooperation between corporation and stakeholders (responsibility)

OECD principles of corporate governance have to be facilitated by proper functioning of national contact points. Thus, the policy options to increase sustainable corporate investments could be through (1) information disclosure and (2) access to information by the corporates. Sustainable corporate governance could be achieved through the following.

- Creation of larger accountability of the board of directors, and linkages between trade agreements and corporate governance principles
- Creation of mandatory environmental and social disclosures
- Enhancement of larger corporate social responsibility among institutional investors

In this regard, it would also be important to initiate a review process for an impact assessment of all these measures.

The book assesses the linkage between economic, environmental, social, and governance dimensions of sustainability and FDI. This assessment is done by analysing the mandatory disclosure norms of TNCs, role of religious perception in host countries, pressure from shareholders of TNCs, and reputational value of firms investing in host countries. The book does not analyse the concept of an optimum FDI for a host country by balancing the environmental, economic, social, and governance costs and benefits arising from such FDI in the host countries. The mechanism and details of designing a sustainable development law with regard to FDI could have been dealt with in the book. The necessity to create a law assessing the degree of environmental compliance in a host country receiving FDI is not covered in the book. Such a law could be designed assessing the extent to which the TNCs are making environmentally compliant investments. A future research question that could also be addressed in this regard is whether a 'strict environmental regime facilitated through economic instruments and FDI would always contribute to sustainability or could generate negative impacts on sustainability due to perverse behaviour of firms as an ex post action to stringent environmental regime'. An answer to this question could contribute significantly in creating a bond between 'FDI' and 'sustainability' in host countries in the longer run.

NEWS IN BRIEF

Trade winds

Russia strives, Tonga enters

Russia's quest for membership of the WTO (World Trade Organization) continues to face roadblocks, but trade officials in Moscow are optimistic that an official accession package can be finalized soon. Russia's entry into the global trade body has been repeatedly blocked by disputes with the EU (European Union) and the US over a number of issues, including intellectual property and trade in energy. Tonga, the tiny South-Pacific kingdom, however, succeeded in its efforts as it became the 151st member of the WTO on 27 July 2007, following more than a decade of negotiations on its terms of entry.

Bridges Weekly Trade News Digest, 1 August 2007

US WTO woes

The US will find it difficult to avoid complying with multiple WTO dispute rulings against its restrictions on overseas Internet gambling. Besides, the Caribbean island nation of Antigua and Barbuda, which brought the case before the WTO, eight members, including the EU, Costa Rica, and Japan served notice that they would seek compensation for lost revenues potentially worth billions of dollars if the US used rarely invoked GATS (General Agreement on Trade in Services) procedures to explicitly exclude internet gambling from its multilateral liberalization commitments.

As if that was not enough, a WTO dispute panel has in a preliminary ruling found that the US had failed to reform cotton subsidy programmes enough to comply with an earlier decision.

www.wto.org

Increase in anti-dumping

The number of anti-dumping investigations initiated by the WTO members increased slightly during the second half of 2006, with China retaining its position as the leading target of new inquiries, according to new data released by the WTO on 11 June. A total of 103 investigations were launched in the second half of last year, up from 96 for the same period in 2005.

www.wto.org

EU looks east

The EU has launched negotiations on far-reaching FTAs (free trade agreements) with India, South Korea, and ASEAN (Association of South-East Asian Nations). All these FTAs are set to cover issues outside the scope of the WTO, such as investment, trade in certain services, intellectual property rights protection, public procurements, competition policy etc. Interestingly, India and some prominent members of ASEAN were at the forefront of opposing these issues at the WTO that the EU pushed hard.

Bridges Weekly Trade News Digest, 25 April 2007

Compulsory license for AIDS drug

Brazil issued a compulsory license for efavirenz, a patented AIDS (acquired immune deficiency syndrome) drug. The compulsory license will allow Brazil to import, and eventually manufacture generic versions of the drug more cheaply. The move by Brazil follows Thailand's compulsory licensing of efavirenz and two other medicines in recent months.

http://ip-watch.org

Rwanda becomes first

Nearly four years after WTO members agreed on a procedure for poor countries to import generic versions of patented medicines that they are unable to produce themselves, Rwanda has become the first country to notify the WTO that it intends to import the HIV/AIDS drug TriAvir; manufactured in Canada by Apotex, a major generics producer.

http://allafrica.com/stories/200708090669.html

No to evergreening

An Indian high court rejected the Swiss pharmaceutical giant Novartis' appeal, challenging the Indian patent law that disallowed a patent application for what it claimed was a new and more effective version of its leukaemia drug Gleevec, known as Glivec. But Indian drug companies, saying it was merely a new form of an old drug, contested this. India's patent law only allows patents for products that represent new inventions, or for an updated drug that shows greater efficacy. It does not grant patent for incremental innovation alone which can evergreen patent rights. Novartis claimed this to be non-WTO compliant. The court advised the company to approach the WTO, if it found the law to be non-WTO compliant.

The Financial Express, 7 August 2007

Lukewarm for agriculture, cold for NAMA

WTO members are in agreement that the parameters for a potential Doha Round agriculture deal identified recently by the chair of the negotiating committee constituted a 'good starting-point' for further talks in September. In comparison, the companion text on industrial tariffs received a much cooler reception. The NAMA (non-agricultural market access)-11 group of developing countries, which includes South Africa, Brazil, and India, finds this disproportionate, both in terms of what is on offer in the agriculture negotiations, as well in its requirement for developing countries to cut their bound tariffs more steeply than developed ones.

Bridges Weekly Trade News Digest, 25 July 2007

Investment currents

European split

European member states are having differences on the issue of treatment of foreign investment in EU's future trade agreements. Earlier, the internal process of the EU led to the formation of a negotiating template termed minimum platform, which featured market access provisions for foreign investments. The template mentioned opening foreign markets to investments from the EU companies. However, it did not include extensive investor protections similar to those found in bilateral investment treaties. The EC's (European Commission) BITs (bilateral investment treaties) template has got approval from EU member governments, although it disappointed some countries that had sought a more ambitious negotiating text.

www.iisd.org/pdf/2007/itn_mar16_2007.pdf

Lawsuit by EC over BITs

The governments of Finland, Austria, and Sweden have moved forward against a lawsuit filed by the EC, saying that certain BITs of these countries infringe upon the EU legal specifications. Earlier in 2004, the EU executive branch had given a notice to these countries, including Denmark, by saying that free movement of investment - related transfers in the BITs of these countries did not abide by the EU rules.

www.ustr.gov/assets/Document_Library/ Reports_ Publications/

Alleged breach of BIT

The US Company, Global Gold Ltd, has made a demand for arbitration against Armenia at the International Centre for Settlement of Investment Disputes. The US firm charged the Armenian authorities on the issue of playing with several gold mining investments. The US firm has also charged the Armenian authorities with refusing to renew and grant appropriate licenses for mining. Global Gold has also challenged by saying that it faced a request from a senior government minister for a $3-million bribe in order to procure the license.

www.bilaterals.org/keyword-articles.php3?id_mot

Notice of CAFTA arbitration

Under the investment chapter of the US–CAFTA (Central America Free Trade Agreement), an investor from the US has lodged an intent notice to sue Guatemala for breaching CAFTA rules. The dispute relates to Guatemalan rail privatization.

www.globalexchange.org/countries/ americas/guatemala/ GuatNewsUpdates.html-52k

Impact of BITs

Signing a BIT with the US does not have an independent effect on attracting foreign direct investment from it. This is the main finding of a study conducted by Kevin P Gallagher and Melissa Birch, entitled 'Do investment agreements attract investment? evidence from Latin America'.[1]

Susan Rose-Ackerman and Jennifer Tobin validate theoretically and empirically that BITs cannot be judged in isolation. The authors, in their study 'Bilateral investment treaties: do they stimulate foreign direct investment?'[2] argue that the impact of BITs on host country FDI (foreign direct investment) flows must be studied by contextualizing the political, economic, and institutional features of the host country that is signing the BIT, along with a holistic view of worldwide BITs regime.

Capital flows scale new height

According to the World Bank's *Global Development Finance Report 2006*, the net private capital flows to developing countries attained the record high figures of $491 billion in 2005, driven by privatization, mergers and acquisitions, external debt refinancing, as well as strong investor interest in local-currency bond markets in Asia and Latin America.

Private capital flows into South Asia attained a record level of $23.6 billion in 2005, rising from $9.7 billion in 2000. A major part of this growth could be attributed to the capital flows in India during this time period. Foreign capital inflows, which have contributed to the South Asian region's record four-year expansion, could however be undermined by security concerns, and the consequent investor sentiment. The nature of monetary inflows in the South Asian region through FDI, portfolio investments, and remittances; and their role in the expansion of capital inflows in the region are shown below.

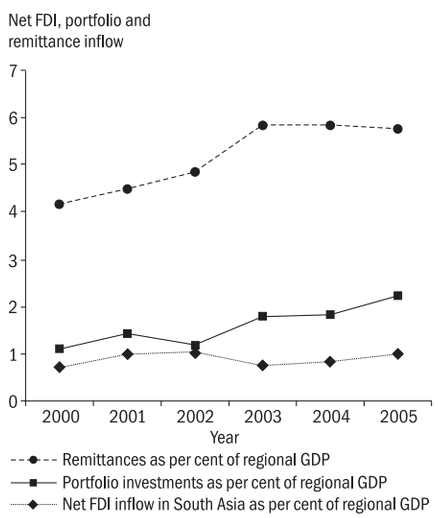

Figure 1 FDI, portfolios, and remittance inflows as per cent of regional GDP in South Asia

FDI – foreign direct investment; GDP – gross domestic product

Source http://web.worldbank.org

[1] *Journal of World Investment and Trade*, 7(6): 961–974

[2] For more details, see www.upf.es/dret/civil/clef/sra.pdf

Energy and resources

EU's Russian nightmare

While renewed tension between Russia and Belarus is yet to disrupt energy flows, it has already sharpened Western Europe's desire to curb dependency on Moscow if it possibly can. Russia postponed its threat to hold back gas after Belarus paid the first instalment of a $456 million debt accrued since Moscow more than doubled the price of gas to Belarus in January this year. This latest flare-up recalled a more serious pricing dispute in January 2006, when Russia cut off supplies to Ukraine, with the knock-on effect of reducing supplies to Europe during its peak demand in the winter months.

The Financial Express, 8 August 2007

Oil and gas crisis predicted

World oil and gas supplies from conventional sources are unlikely to keep up with the rising global demand over the next 25 years, the US petroleum industry says in a draft report of a study, commissioned by the US government, entitled *Facing the Hard Truths about Energy*. The surge in demand is expected to arise from rapid economic growth in such fast-developing countries as China and India, as well as mounting consumption in the US, the world's biggest energy market. The study was conducted by the National Petroleum Council, an industry group.

The Wall Street Journal, 17 July 2007

Indian oil firms eye Brazilian shores

Acquisition of sugar cane acreage in Brazil is next on the agenda for oil companies such as the BPCL (Bharat Petroleum Corporation Limited), IOC (Indian Oil Corporation), HPCL (Hindustan Petroleum Corporation Limited), and ONGC (Oil and Natural Gas Corporation Limited) Videsh, who have so far been engaged in acquiring oil and gas assets abroad. Domestic oil companies plan to form a joint venture with a two-pronged strategy – greenfield development, as well as acquisition of ethanol acreage – in Brazil. It is stated that Japan and China have already taken the lead in acquiring ethanol acreage in Brazil.

The Economic Times, 14 August 2007

N-power from fertilizer waste

The Government of India will set up a facility at Paradip in coastal Orissa to extract uranium from waste material generated by two fertilizer units in the vicinity. According to sources, certain waste and by-products from Paradip Phosphates Ltd, as well as the Indian Farmers' Fertilizer Cooperative Ltd unit in Paradip contain uranium, a radioactive metal, and fluorine.

The Asian Age, 11 August 2007

Malaysian 'pipe-dream'

Malaysia's bold plan to build a $7-billion pipeline across the country as a way of providing a short cut for Middle East crude bound for East Asia was recently approved by Malaysia's cabinet. Malaysia and neighbouring Thailand have toyed for many years with the idea of piping oil from the Andaman Sea to the South China Sea, removing the need to ship crude oil through the Malacca Strait around the Malayan peninsula. The pipeline aims to cut time and costs by bypassing the crowded strait. But in the corridors of the oil industry, there are still plenty of doubts about the economic aspects of the project.

http://www.reuters.com/article/inDepthNews/idUSSP412620070809

Kazakh oil and gas to flow east

Kazakhstan and China have agreed to build pipelines to carry oil and gas from fields near the Caspian Sea to China. An agreement in this regard was signed on 18 August. The agreement marks a setback for the EU and the US, both of which have urged Kazakhstan to export oil and gas across the Caspian to western markets. Last year, Kazakhstan and China completed a pipeline from the central part of Kazakhstan to Xinjiang province, China. That pipeline will now be extended to western Kazakhstan, creating an export route, spanning the breadth of Kazakhstan from the Caspian to China.

http://www.oilonline.com

Venezuelan moves

Investors eye legal options as Venezuela moves to control heavy oil projects. Foreign oil companies are looking for ways of international dispute resolution, as Venezuela plans to nationalize the majority stake in expensive oil projects. Hugo Chavez has signed a decree, according to which the foreign firms had to sign up joint venture agreements. This agreement has given state oil company a stake of majority in the oil projects.

www.iisd.org/pdf/2007/itn_mar2_2007.pdf

India seeks swap deal with Japan

India is trying to impress upon Japan to consider the possibility of swapping or selling gas from OVL's (ONGC Videsh Ltd) blocks in Sakhalin-I in return for gas that the island nation sources from West Asia. Such a deal will enable both the countries to reduce transportation costs of gas as Japan is closer to the Sakhalin Islands and in turn India is closer to West Asia.

In fact, India is also looking for a board-based cooperation on energy with Japan. Energy security is a vital issue for both countries as Japan is the world's third-largest oil consumer after the US and China, while India is the world's fifth-largest. OVL and Japan Oil and Gas Metal National Corp. (Jogmec) already have an MoU (memorandum of understanding) in place, which is proposed to be converted into an alliance for making joint bids in overseas hydrocarbon projects as well as sharing of technological expertise.

http://www.livemint.com/2007/08/19190242/Swap-deals-sought-in-hydrocarb.html?atype=tp

Environment and development

IPCC working group reports

The working groups of the *Fourth Assessment Report* by the IPCC (Intergovernmental Panel on Climate Change) have come out with their reports on 'the physical science basis', 'impacts, adaptation and vulnerability', and 'mitigation of climate change'. The IPCC is in the process of finalizing this report. The *Synthesis Report* is going to cover different issues and dimensions of climate change such as causes, impact in different scenarios, adaptation and mitigation options, scientific and socio-economic aspects relevant to adaptation and mitigation, consistent with the objectives and provisions of the UNFCCC (United Nations Framework Convention on Climate Change), and sustainable development.

http://www.ipcc.ch

India wakes up to climate change

As a follow-up to the consensus that India should have a domestic policy on climate change, a high-level advisory panel to formulate Indian strategy on climate change was set up on the World Environment Day. The Prime Minister's Council on Climate Change is meant to coordinate national action plans for the assessment, adaptation, and mitigation of climate change. Besides making policy recommendations, it will facilitate inter-ministerial coordination.

The Hindu, 6 June 2007

IP and genetic resources

The 11th session of WIPO (World Intellectual Property Organization) IGC (Intergovernmental Committee) on Intellectual Property and Genetic Resources, Traditional Knowledge, and Folklore was held. The central focus of the meeting was to understand the international dimension of intellectual property, genetic resources, and traditional knowledge. It was recommended that the WIPO mandate should be renewed for an additional two years.

http://www.wipo.int/meetings/en/details.jsp?meeting_id=12522

Biofuels for the Convention on Biological Diversity

The 12th meeting of the SBSTTA (Subsidiary body on scientific, technical, and technological advice), a working group of the CBD (Convention on Biological Diversity), was held in Paris during 2–13 July. Issues concerning biofuel production were discussed. The groups also took note of the importance of considering trade implications of any new CBD policies on biofuels. The need to address the inter-relationship between CBD biofuels policies, and other environmental and trade agreements was also looked into.

http://www.cbd.int/doc/meetings/sbstta/sbstta-12/official/sbstta-12-08-en.pdf

Asian Development Bank reports widening gap

Inequality is rising in most Asian countries, endangering the prospects of sustained growth, and weakening social cohesion in these nations, the ADB (Asian Development Bank) said in its *Key Indicators 2007* report. The report states that if adequate data on income distribution in India was available, the increase in income inequality would have been much sharper than the expenditure inequality. Further, while wages for English-speaking graduates are rising rapidly in India, pay for unskilled labour is stagnating. In China, too, inequality has risen sharply, with the Gini coefficient (a standard measure of income inequality) increasing to 47.3 in 2004 from 40.7 in 2003—a level more typical of Latin America, the bank said.

Economist, 9 August 2007

Compensation in Bhopal gas case

A bench comprising Justices C K Thakker and H S Bedi heard a petition asking for more compensation in the Union Carbide case. It was argued that the total amount of compensation awarded was too meagre in relation to the scale of the loss of life, and the extent of its detrimental effects. Therefore, it was suggested that the compensation should be enhanced to ensure justice. The Supreme Court dismissed the application on the basis of the limitations set by the lapse of 18 years.

The Tribune, 5 May 2007

EC biotech regulation

The EU has agreed with the US, Argentina, and Canada on a 21 November deadline for compliance with the WTO dispute. In September 2006, the EU was asked to bring the moratoria on the approval of new biotech products in line with the provisions of the SPS (Sanitary and Phyto-sanitary) Agreement .

http://www.ictsd.org/biores/07-07-06/story1.htm

Blue Lady gets SC's approval

On 11 September 2007, the Norwegian cruise liner Blue Lady got the Supreme Court's approval for dismantling. After the ship was docked at Alang ship-breaking yard in India in August 2006, various environment groups had taken the matter to the Supreme Court alleging that 1240 million tonnes of radioactive material and asbestos could put the lives of the labourers at risk. The purchaser of the ship, on the other hand, alleged that it would generate employment and the 2% of asbestos in the ship would be disposed off properly. The apex court's order has not gone down well with the environmental organizations. They may even file a revision petition.

The Economic Times, 17 September 2007

Note

The news items have been collected from different sources only for the purpose of briefing the readers. Though care has been taken to ensure their accuracy, the readers may check for authenticity before further use.

About TERI

TERI, established in 1974, is a not-for-profit, non-government organization deeply committed to every aspect of sustainable development. Over the years, TERI has been working with governments, multilateral organizations, and corporate entities in providing comprehensive support on aspects, such as policy issues, project evaluation, and technology. TERI has regional centres in Bangalore, Goa, Guwahati, and Mukteshwar; an office in Mumbai; and a presence in Japan and Malaysia. It has also set up affiliate institutes: TERI-North America in Washington DC, USA; TERI-Europe in London, UK; and TERI-Gulf in Dubai, UAE.

About GALT

The Centre for Global Agreements, Legislation and Trade (GALT) is an area within the Resources and Global Security Division of TERI. The broad objectives of the area are

- *to engage in research in the area of trade and sustainable development from an economic and legal perspective;*
- *to engage in capacity building through training programmes, workshops, and seminars;*
- *to create awareness through an effective dissemination of knowledge and dialogue amongst policy-makers, academia, practitioners, and other stakeholders.*

Based on these objectives, GALT is committed to working on the following issues.

- *Trade and environment (such as linkages between the World Trade Organization, trade agreements, and multilateral environmental agreements)*
- *Trade and socio-economic development (such as trade and inequality, gender and globalization)*
- *Trade and governance (such as trade and environmental negotiations and their implications on national and international regulatory regimes of governance)*
- *Trade and investment with an emphasis on resource development and use*

For subscription, contact

Anandajit Goswami
Centre for Global Agreements, Legislation, and Trade
TERI, Darbari Seth Block
IHC Complex, Lodhi Road
New Delhi – 110 003/India

Tel. 2468 2100 or 4150 4900
Fax 2468 2144 or 2468 2145
India +91 • Delhi (0) 11
E-mail anandjit@teri.res.in
Web www.teriin.org