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How does outward foreign direct investment contribute to economic development in less advanced home countries?

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ABSTRACT

In view of the rapid increase of outward foreign direct investment (OFDI) from emerging economies in recent years, this study examines how OFDI supports economic development in the world's less advanced home countries. Drawing on theories of FDI, available literature of relevance and some recent evidence from emerging economies, this study finds that the objective of multinational enterprises to pursue assets and advantages abroad through OFDI can yield financial, intangible capability and tangible capacity returns. In the right circumstances, these returns generate important macroeconomic gains, mitigate some of the typical problems of economic development and provide broader benefits to societies. Despite some limitations, OFDI complements, sometimes in distinct ways, the development benefits many countries already realise through trade, migration and inward FDI. Emerging economies are best placed to benefit from the returns generated by OFDI.

1. Introduction

A large number of studies have analysed how inward foreign direct investment (FDI) contributes to economic development and growth in less industrially advanced countries (Crespo & Fontoura, 2007; De Mello, 1997; Fan, 2003; Ghauri & Yamin, 2009; Görg & Strobl, 2001; JBICI, 2002; Lim, 2001; Moran, Graham, & Blomström, 2005; Ozawa, 1992; Saggi, 2002). These studies have focused on the impact of investments made by advanced economy multinational enterprises (MNEs) in *host* economies at earlier stages of the development process. *Outward* foreign direct investment (OFDI), in turn, was thought of first and foremost as a consequence of economic development (Dunning & Narula, 1996). Thus, very little attention has been paid to the contribution which OFDI makes to the development of *home* countries when the investing multinationals are from less advanced economies.

However, with the advent of multinationals from emerging economies as global investors in the last 10–15 years (Bonaglia, Goldstein, & Mathews, 2007; Sauvart, 2005; UNCTAD, 2006), and the radical shift this has brought to the global FDI landscape, such a narrow focus on host economy development needs to be revisited. Today, the countries producing successful multinationals, such as Brazil, China, India, Mexico, Russia, South Africa and Turkey, are themselves still in the middle of a challenging economic development process, encountering typical problems of economic development such as technological backwardness, poor infrastructure, environmental

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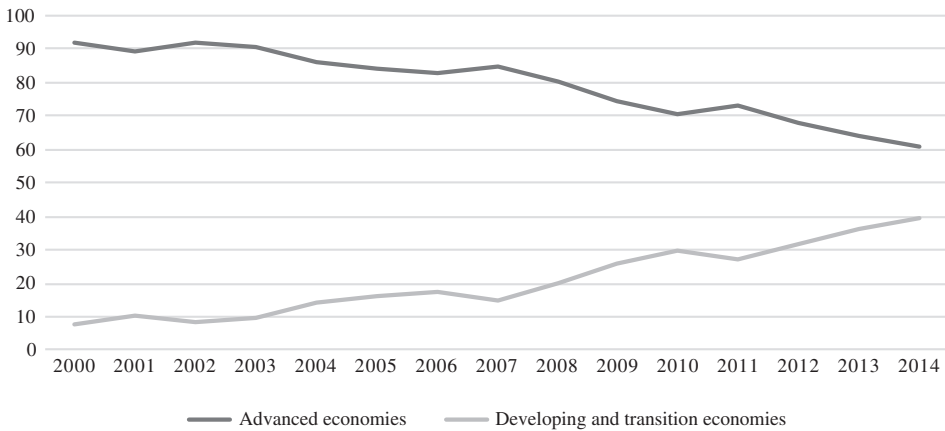


Figure 1. Share of global OFDI flows, 2000–2014 (%). Source: UNCTADStat database.

degradation and poverty. But despite such constraints, Figure 1 reveals that OFDI from these and other developing countries has risen sharply since the millennium, reaching US\$460 billion or 39% of global FDI outflows in 2013 (UNCTAD, 2014). Multinationals from these countries also exhibit novel investment patterns and frequently target the advanced economies as locations for their FDI. The examples of ‘emerging multinationals’ in Table 1 illustrate their diverse nature of activities and wide global reach.

With less advanced economies now emerging as important sources of FDI, the research community concerned with the development implications of FDI needs to pay greater attention to the role OFDI plays in further advancing the economic development of the countries from which these investments originate. Some countries, such as China, Malaysia and Singapore, explicitly promote OFDI (Dunning & Lundan, 2008; Luo, Xue, & Han, 2010), and better knowledge of the mechanisms through which OFDI contributes to economic development in home countries would certainly help inform government policy.

In this paper, I make an initial advance towards closing this gap in current research. I proceed in three distinct analytical steps. Firstly, I review the theoretical and empirical literature on FDI that helps explain the contribution emerging multinationals make to economic development processes in their home economies. Secondly, I draw on available information and data on emerging economy multinationals investing abroad, establishing a framework to capture the diverse mechanisms and channels through which OFDI can contribute to economic development in the world’s less advanced home countries. Thirdly, I assess the strengths and limitations of OFDI as a contributor to economic development in the investors’ countries of origin. I focus my analysis on the emerging economies, as they are the ones which have produced a considerable number of multinationals. I subsequently consider the implications for low-income home countries not classified as emerging economies.

As most emerging multinationals have only recently embarked on a process of internationalisation, a state-centric interpretation – viewing the multinational as a distinct product of its home economy (Gilpin, 2001, p. 288) – applies to this study. Moreover, the conceptualisation of the term ‘development’ within this study includes both quantitative expansion – i.e. increases in the size of the economy – as well as more qualitative contributions to the economy such as economic restructuring, technological advancement, sustainability, and improved productivity or efficiency (Soubbotina, 2004, p. 133). I also consider ‘development’ to be a process which the advanced industrialised countries have successfully concluded.

Table 1. Examples of investing companies from developing and transition economies.

Company	Industry	Home economy	Investment activities
Acer	Information technology	Taiwan	Investments in developing and developed countries (including the US), through acquisitions and greenfield FDI
AIC Corporation	Semiconductors	Malaysia	Investments in China, Singapore and Thailand
Arçelik	White goods	Turkey	Investments in Romania, Russia and other European countries
Cemex	Cement	Mexico	Investments in developing and advanced economies, including acquisitions in Europe and Latin America
City Developments Ltd (CDL)	Hotels	Singapore	International expansion through M&As in Southeast Asia, Oceania, Europe, etc.
China National Offshore Oil Corporation (CNOOC)	Oil and gas	China	Global acquisition of oil and gas fields, including Nexen in Canada
Companhia Vale do Rio Doce	Metals and mining	Brazil	International mining operations, supported with business investments globally
Gazprom	Oil and gas	Russia	Wide range of investment activities in developing and advanced economies
Haier	White goods	China	Investments globally, including in the US, Europe, Asia and Africa through greenfield FDI and acquisitions
Hikma Pharmaceuticals	Pharmaceuticals	Jordan	Investments in developing and advanced economies (e.g. Portugal and the US)
Huawei	ICT	China	Wide range of investments in developing and advanced economies
Mabe	White goods	Mexico	Investments throughout the Americas (e.g. in Brazil, Canada, Colombia, Ecuador, and Venezuela), including acquisitions
Mittal Steel/Ispat	Steel	India	Investments in developing and advanced economies, including acquisitions in the US and Europe
Lenovo	Personal computers (PCs)	China	The world's leading PC company by market share, with investments globally (greenfield and acquisitions); acquired IBM's PC business in 2004
Lukoil	Oil and gas	Russia	Oil and gas exploration and extraction projects in oil-rich countries
Marcopolo	Buses and coaches	Brazil	Investments in developing and advanced economies (e.g. Portugal)
Tata Motor	Automobiles	India	Investments in developing and advanced economies (e.g. Argentina, South Africa, UK)

Sources: Bonaglia et al. (2007), Kalotay and Sulstarova (2010), Mathews (2006), UNCTAD (2006).

2. Insights from the theoretical and empirical literature

The conventional theories of the multinational enterprise, favoured by business economists for several decades, are dominated by the thinking that firm-specific and oligopolistic advantages already possessed by the multinationals are a necessary prerequisite for the occurrence of FDI (Dunning, 2001a; Hymer, 1976; Vernon, 1966). Traditional, most commonly referenced theories explain FDI as an activity to exploit competitive (i.e. 'ownership' or 'proprietary') assets (Caves, 1971, 1974; Dunning, 2001a, 2001b; Hymer, 1976; Kindleberger, 1969), underlining the view that firms conducting FDI are economically strong and dominant when entering the host country.

But recent studies of emerging multinationals have begun to expose the weaknesses of traditional theories to fully explain FDI from less advanced economies (Buckley et al., 2007; Child & Rodrigues, 2005; Fosfuri & Motta, 1999; Gammeltoft, Barnard, & Madhok, 2010). These advances in FDI theory observe that firms also seek or augment assets when they invest abroad, usually in parallel with asset exploitation activities (Dunning, 2001a, 2001b; UNCTAD, 2006; Wesson, 1999). Complementing the theoretically dominant OLI (ownership, location, internalisation) paradigm (Dunning, 2001a, 2001b), the newly developed LLL approach posits that firms investing abroad can develop competitive

advantages through linkage, leverage and learning (Mathews, 2006; Li, 2007). Moreover, FDI theory often distinguishes between market-seeking, efficiency-seeking, resources-seeking and strategic asset-seeking FDI (Dunning & Lundan, 2008; Narula & Dunning, 2000). Empirical and case studies examining emerging multinationals from economies such as China (Child & Rodrigues, 2005; Deng, 2007; Knoerich, 2010), Indonesia (Lecraw, 1993) and Taiwan (Makino, Lau, & Yeh, 2002) confirm that companies from less advanced economies actively seek assets and advantages when they invest overseas, including know-how, (natural) resources and foreign markets.

These kinds of perspectives, portraying FDI as a pursuit of various advantages rather than the exploitation of proprietary assets, are corroborated by theories of the firm. Available evidence employing the resource-based view (Barney, 1991; Barney & Hesterly, 1996) finds emerging multinationals in weak strategic situations investing abroad to acquire the resources they need to compete successfully (Deng, 2008). Similarly, the knowledge-based view (Hedlund, 1994; Kogut & Zander, 1993) suggests that firms from developing countries may undertake overseas investments for knowledge sourcing. Finally, the learning-based view emphasises transaction value gained by the investing firm through cross-border learning (Li, 2010).

A theoretical focus on the pursuit of assets and advantages is more suitable than the asset exploitation-narrative for analysing the contribution of OFDI to economic development in the less advanced countries from which the investments originate. This is because it enables the examination of how the assets or advantages pursued – such as markets, technologies, resources, networks, factories, linkages or other kinds of tangibles or intangibles – support the development of the home economy, either by means of direct transfer and utilisation back in the home economy, or through more indirect channels. In addition, this perspective places less emphasis on the essentiality of ownership advantages in explaining FDI behaviour. Multinationals from less advanced economies tend to have weaker ownership advantages and firm-specific capabilities (Lall, 1983; Wells, 1983), at times investing in more advanced economies from a position of competitive weakness (Li, 2007; Luo et al., 2010; Wesson, 1999), and some may even be ‘multinationals without advantages’ (Fosfuri & Motta, 1999).

In fact, this theoretical perspective holds regardless of the nature or existence of ownership advantages, or the origin of multinationals in advanced, emerging or developing countries. Many studies have confirmed that multinationals from advanced economies investing overseas seek assets and advantages as well (Almeida, 1996; Cantwell, Dunning, & Janne, 2004; Dunning, 1996; Kuemmerle, 1999; Shan & Song, 1997).

Several studies have attempted to quantify the impact of OFDI in the world’s leading home economies such as the United States, Japan and European countries. This empirical evidence suggests that when a quantifiable impact was found it most often tended to be small but positive (Bergsten, Horst, & Moran, 1978; Dunning & Lundan, 2008; Kojima, 1973; Kojima & Ozawa, 1984; Kokko, 2006; Lipsey, 2004; Ozawa, 1992). OFDI has been found to enhance growth and output (Herzer, 2008, 2010), exports (Chédor, Mucchielli, & Soubaya, 2002; Hijzen, Jean, & Mayer, 2011; Lipsey & Ramstetter, 2003), employment (Federico & Minerva, 2008; Hijzen et al., 2011), productivity and efficiency (Driffield & Love, 2005; Egger, Pfaffermayr, & Wolfmayr-Schnitzer, 2001; Sunesen, Jespersen, & Thelle, 2010; Van Pottelsberghe de la Potterie & Lichtenberg, 2001) and know-how (Globerman, Kokko, & Sjöholm, 2000; Herstad & Jónsdóttir, 2006; Popovici, 2005) in particular advanced home economies. These studies may only offer a limited amount of insight, given their focus on just a few countries or country groupings and obvious data limitations, arising, in particular, from the aggregate nature of some datasets which were used. Nevertheless, they might suggest that similar effects should play a role in the developing home economies, which is encouraging for the purpose of our study. Unfortunately, explicit discussions of an impact on developing home countries have been limited to a few rare exceptions (UNCTC, 1993), and empirical evidence has been lacking entirely.

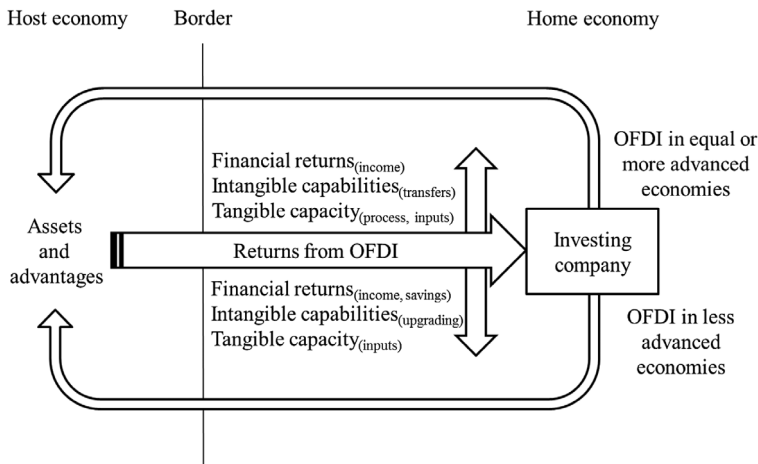


Figure 2. Contribution of OFDI to economic development: an analytical framework.

3. The returns from OFDI

The effective and successful pursuit of assets and advantages abroad will result in the generation of *returns* by the multinational enterprise conducting the investment. Conceptually, returns may consist of those assets or advantages the pursuit of which formed the original rationale for the investment (e.g. a technology sought specifically through the investment is transferred back home), or they may comprise secondary benefits realised from the pursuit of assets and advantages (e.g. access to a market through OFDI yielding financial profits). The contribution of these returns to the home economy can be either firm-specific in nature, benefiting the investing firm, or it can involve broader gains and benefits to other firms or economic actors. Most notably, returns have a beneficial impact on economic development if they help mitigate certain development needs faced by a home economy, such as financial or technological constraints, capability bottlenecks, resources shortages or a low amount of exports.

Figure 2 provides an analytical framework which captures the returns from OFDI. In addition to financial returns, which are the traditional purpose of an investment, a particular attribute of FDI is its potential to also generate returns of intangible capabilities and tangible capacity. The following sections discuss each of these returns in greater detail. The precise nature of these returns tends to differ depending on whether the investment is made in economies which are equally or more advanced relative to the investing multinational's home country, or in less advanced economies.

3.1. Financial returns

Successful investments by nature yield quantifiable financial gains for the investing firms as they make profits overseas or generate other earnings. Figure 3 depicts FDI income and rates of return on investment in 2011 for 10 leading emerging economies. FDI income has been a few USD billion for most of these countries, with rates of return at 5% on average. Rates of return from FDI tend to exceed other types of investment returns (UNCTAD, 2013, p. 31). Usually, a proportion of these investment-related earnings are repatriated to the home economy. Repatriated returns on FDI can be substantial, although they tend to fluctuate over time (UNCTAD, 2006). Although data for developing countries are lacking, around US\$1 trillion of global earnings from FDI were repatriated to the home economy or other countries in 2011 (UNCTAD, 2013, p. 33). Financial returns are transferred to the home economy via transactions involving banks or other financial institutions, or through mechanisms internal to the firm such as within-firm financial payments or transfer pricing.

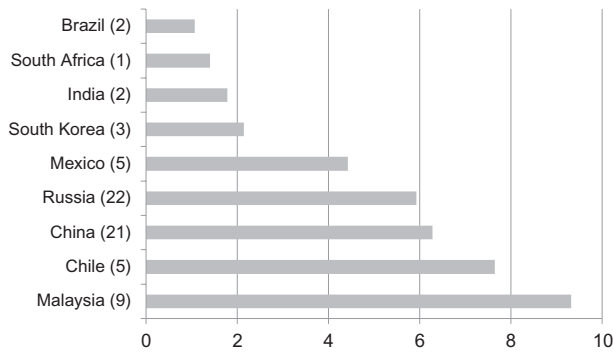


Figure 3. Rates of return (%) from OFDI in 2011 for leading emerging economies. Source: IMF (2012). Rates of return are calculated by dividing FDI income in 2011 by the average of the FDI positions for 2011 and 2010 (UNCTAD, 2013).

Note: Figures in parentheses indicate foreign direct investment income in 2011, USD billion.

Financial returns result from income and profits generated by the sales of products and services produced in the host economy or exported from the home economy. Represented as ‘financial_(income)’ returns in Figure 2, they are particularly significant when FDI is made in more advanced, high-income markets, but they also result from investments in less advanced countries. They are a typical result of vertical and trade-supporting OFDI which complements economic activity in the home economy (Kojima, 1973, 1975; Kojima & Ozawa, 1984; Lipsey, 2004). Chinese firms, for example, have invested heavily in sales offices and assembly operations in Europe in order to strengthen exports of low-cost products which are still made in China (Knoerich, 2012). Some OFDI enhances the sale of intermediate goods (often relatively more high-tech components) to production locations in other countries, generating financial returns as well. One example of this is Taiwanese offshoring to mainland China.

In addition, OFDI is made in less advanced host countries in order to take advantage of lower input and labour costs in manufacturing and other activities. This cost-saving OFDI yields a different kind of financial returns, referred to as ‘financial_(savings)’ returns in this study.

Financial returns from OFDI are not limited to the investing firm but may be visible at a more macroeconomic level. Although evidence on this to date is scant, we should expect OFDI to create opportunities for the multinationals’ locally embedded suppliers in the home economy. The financial earnings made by these firms from providing intermediary products and related commercial services to the investing multinationals and their overseas subsidiaries resemble another form of financial_(income) returns. They have the potential to benefit smaller and weaker enterprises which may by themselves not enjoy the receipt of financial payments from overseas customers and business partners.

The enhanced availability of finance is central for development. Not only does a healthy financial position help strengthen and maybe even enlarge the investing multinational, but the development of local, possibly small- and medium-sized enterprises may be supported as well. Particular development contributions are realised when financial returns are converted for use in activities and projects which are important for home economy development. The firms may, for example, invest in further industrial expansion, domestic R&D, skills enhancement or green projects.

Exports yielding financial returns are often serviced by an expansion of industrial output and production in the home economy, in line with an export-oriented growth strategy. In addition to generating foreign exchange, this can create additional domestic employment so that some of the financial returns will be converted into wages, enhancing the opportunities and incomes of the population in the less advanced economy. Ultimately, a greater financial wealth at the enterprise and individual levels contributes to raising domestic fixed capital formation, national savings, consumption and tax revenue.

3.2. *Intangible capability returns*

By investing overseas, multinationals generate returns of intangible capabilities in the form of additional knowledge, skills, technological upgrading, managerial expertise and a brand's goodwill. When investments are made in more advanced economies, 'intangible capability_(transfers)' returns are generated primarily as a result of the pursuit of know-how and strategic assets in the host economy and their transfer back to the home economy. The benefits to firms from less advanced economies could be especially significant, as the variety and sophistication of technologies, know-how and skills is usually greater in more advanced economies.

Mergers and acquisitions (M&As) and other forms of alliances and partnerships with companies in host countries are particularly valuable opportunities for the generation of intangible capability returns, as the internal knowledge and assets of the firms involved become directly accessible to the partner firms (Ahuja & Katila, 2001; Bresman, Birkinshaw, & Nobel, 1999; Inkpen, 1998; Ranft & Lord, 2002). This circumvents time-consuming efforts of domestic, in-house innovation. For example, the Turkish firm Arçelik acquired brands in Europe through M&As (Dunning & Lundan, 2008), and the acquisition of IBM's PC business in 2004 elevated Lenovo's international competitive position to first in terms of global market share through technological upgrading (Rui & Yip, 2008). The opportunity of fast-track access to know-how and technologies may be an explanation for why as much as 56% of global cross-border M&As were undertaken by multinationals from developing and transition economies in 2013 (UNCTAD, 2014).

Intangible capability returns may also be the result of 'reverse' linkages and spillover effects in advanced host economies. Reverse spillover effects have been empirically proved to exist in the manufacturing sectors of the United Kingdom (De Propriis & Driffield, 2006; Driffield & Love, 2003, 2005), and some concrete yet tentative evidence is emerging that multinationals from emerging economies also benefit from them (Chen, Li, & Shapiro, 2012), including multinationals from China (Huang & Wang, 2009) and Brazil (Mendes Borini, de Miranda Oliveira, Freitas Silveira, & de Oliveira Concer, 2012).

By reversing the analytical thrust of the traditional literature on FDI spillovers (JBICI, 2002; Saggi, 2002), we can discern three possible types of 'reverse' spillovers. Firstly, 'reverse' horizontal linkages may result from exposure to local competitors with more advanced capabilities in host countries. A 'reverse' competition effect could push firms from less advanced economies into adjusting and enhancing their performance in order to stay competitive in the host economy, and a 'reverse' demonstration effect occurs when investing firms improve their capabilities by observing, imitating and adopting practices and technologies of host country firms. For example, many subsidiaries of Chinese firms in advanced economies function as 'listening posts' for their parent firm (Knoerich, 2012; Von Zedtwitz, 2006). Secondly, 'reverse' vertical linkages may occur. Through 'reverse' forward linkages, an investing firm may receive information, know-how, technical assistance or training from its customer firms in more advanced economies. 'Reverse' backward linkages may, in turn, offer opportunities for the procurement of advanced producer goods and other high-technology inputs from suppliers in the advanced economy where the investment is made. Finally, through 'reverse' labour turnover, well-educated and high-skilled employees hired in the advanced host economy bring new types of (tacit) knowledge and experience into the investing multinational.

Capabilities acquired by firms investing overseas and transferred to the home economy may spread via knowledge diffusion from headquarters to other companies there, facilitated by the fact that outward investing firms are 'local' in origin, exhibit similar characteristics and capabilities to domestic firms, cultivate strong domestic linkages and have a profound embeddedness in their home economy. In addition, intangible capability returns may also improve standards in the home economy, as multinationals introduce quality, environmental, labour, managerial and other standards encountered overseas into their home economy operations. But although the benefits for multinationals from 'reverse' spillovers and the diffusion of knowledge and standards in the home economy are plausible from a theoretical point of view, research still needs to provide empirical confirmation of the positive effects for less advanced economies.

Finally, the generation of intangible capability returns is not only possible when companies make investments in more advanced economies. Especially when OFDI taps into low-cost, unskilled labour in economies which are even less advanced than the country of origin of the investing firm (as would be the case with horizontal, trade-substituting OFDI), the resulting movement of labour-intensive economic activity from home to host economy may force the labour force composition in the home economy to shift in the direction of higher-end activities, thereby inducing economic upgrading (Kojima, 1973, 1975; Kojima & Ozawa, 1984; Lipsey, 2004; Moran, 2006). Capital- and skill-intensive production would start dominating output and exports, allowing ‘white collar’ employment to increase and wages to rise with higher worker productivity (Moran, 2006). Such ‘intangible capability_(upgrading)’ returns have, for example, been observed in Taiwan once Taiwanese firms started offshoring labour-intensive production to mainland China (Tsai, 2015).

In sum, intangible capability returns help upgrade firms in less advanced home economies. As this process eases technological deficiencies and lack of know-how in the less advanced economies from which the investments originate and supports technological advancement and catching up, there will be beneficial effects on the competitiveness and upgrading of home economy industries.

3.3. Tangible capacity returns

OFDI can enhance production capacities in the home economy as well as capacities to construct, operate, sell and consume, thereby supporting processes of development and industrialisation. ‘Tangible capacity_(process)’ returns are generated when machinery and capital goods, normally acquired in more advanced economies through OFDI, are physically shipped back to the home economy to improve home economy production processes and enhance productivity. Imports of capital goods, machinery and equipment and a broader variety of intermediate goods have been found to boost productivity in developing countries (Coe, Helpman, & Hoffmaister, 1997). Similarly, the overseas acquisition of brands can expand a company’s sales in the home economy and beyond.

‘Tangible capacity_(inputs)’ returns, in turn, occur when multinationals use OFDI to acquire natural resource companies, mines and oilfields, obtain exploration and exploitation rights, and purchase land. Chinese companies have been on a recent global quest to secure oil and gas concessions and mines for the extraction of a variety of raw materials (Buckley et al., 2007; Cai, 1999; Chen, 2011; Deng, 2004; Ma & Andrews-Speed, 2006). Russian energy companies are also active internationally, and companies from various high- and middle-income countries have engaged in land investments overseas to secure food supplies (Smaller & Mann, 2009; Von Braun & Meinzen-Dick, 2009).

Tangible capacity_(inputs) returns are generated directly when particular quantities are shipped back to the home country. For example, there are instances where Chinese companies have shipped raw materials extracted from an investment back to China (Cai, 1999; Deng, 2004). Alternatively, output is sold on the international market, resulting in an expansion and diversification of global supply (Chen, 2011; Moran, 2010) and a possible reduction of raw material prices globally and to the benefit of any buyers in the home economy. Similar scenarios may be found with intermediate and final products manufactured overseas, especially if incorporated more securely within a firm’s own production chain.

As economies industrialise and develop, they become increasingly dependent on overseas resources, especially when local endowments become insufficient (Ozawa, 1992), or resources are unavailable, scarce or expensive in the home country. By securing longer-term ownership and control over relevant assets in foreign countries, OFDI helps mitigate these shortages and increase capacities, thereby promoting economic growth and stability. It is also a strategy to minimise risks and ensure stability and continuity of the economic development process. Given existing uncertainties and the international price volatility of commodities and some intermediate goods, sole dependence on the market entails large risks for rapidly growing home economies and their firms. Many commodities and intermediate products are used in the home economy as inputs for production processes in export-oriented sectors, as material for the construction of critical infrastructure, to meet a developing country’s rising energy requirements and reduce energy shortages, or to enhance food security.

4. Assessing the importance of OFDI for economic development

The previous discussion has shown the various ways in which all three types of returns from OFDI support less advanced economies in achieving greater levels of economic development and industrialisation. The importance of OFDI for development should therefore not be underestimated. In particular, it is worth highlighting the unique position of middle-income countries and emerging economies. Their firms' ability to generate returns from investments in economies which are more *and* less advanced than the home economy, along both arrows in Figure 2, allows them to maximise the variety of developmental gains from these returns. This is because they can benefit from the effects represented in both arrows. Advanced economies benefit primarily from their outward investing multinationals generating returns in the lower arrow (and some limited benefits of the upper arrow when the investment flows to economies at equal level of development), while less advanced countries other than the emerging economies benefit primarily from their firms overseas generating returns of the upper arrow – if at all (see Figure 2). One may argue that advanced countries and their firms benefit relatively more than emerging economies and their firms from financial_(savings) and intangible capability_(upgrading) returns, due to high costs at home and their need to offshore lower-end productive activities. Emerging economy firms, in turn, should experience relatively larger gains from intangible capability_(transfers) and tangible capacity_(process, inputs) returns. It is these returns which help them overcome their significant technological and knowledge deficiencies, enhance production capacities and achieve greater stability by establishing security of access to inputs, raw materials and energy resources (which is something advanced economies have already achieved). Intangible capability_(transfers) returns are particularly valuable in developmental processes as they support industrial and technological upgrading and catch-up.

4.1. Limitations and prerequisites

These positive contributions which OFDI makes for development might, however, be derailed in a number of ways, and there may be some harmful effects. First of all, many lower-income countries suffer from a shortage of capital, and OFDI may exacerbate such shortages as it involves an initial outflow of capital for an unspecified period of time. OFDI may crowd out domestic investment especially if domestic firms have insufficient funds at their disposal (Lee, 2002, p. 103). Over time, however, any initial shortages will be mitigated by the financial returns, which may eventually offset and surpass the initial outflow of capital. In fact, OFDI has been found to interact with domestic investment in a situation of positive interdependence between them (Stevens & Lipsey, 1992), and domestic investment may not be affected if firms hold sufficient funds for both domestic and foreign investment (Lee, 2002, pp. 103, 104). There is also less of an effect on domestic investment if companies source capital for their foreign investments from overseas sources, such as financial institutions in the host country.

Secondly, as production is relocated to overseas destinations, OFDI may crowd out other economic activity in the home country, such as production, exports and employment (Debaere, Lee, & Lee, 2010), reducing workers' income and tax revenue as a consequence. This 'offshoring' effect may, however, be less pronounced in less advanced home economies, where production costs still tend to be low. Studies of advanced home economies have also confirmed the limits to such concerns, indicating that complementarities resulting from OFDI tend to outweigh these substitution effects (Dunning & Lundan, 2008; Kokko, 2006), and suggesting that OFDI helps preserve home economy production, exports and employment (and eventually income and tax revenue), at least in part (Blomström & Kokko, 1998; Lipsey, 2004; Lipsey & Weiss, 1981; Moran, 2006).

Even when such harmful effects do not occur, OFDI may not make a contribution to development, as successful generation of returns from OFDI requires the existence of a number of prerequisites. Most notably, a sufficient number of firms from the home economy must be involved in relevant activities in order to generate any significant development contribution at a macro-level. This can be particularly problematic for low-income countries with a limited number of multinationals. When FDI outflows

are limited the returns from them will be limited as well. Moreover, assets and advantages have to be available and accessible overseas; for example, foreign firms, mining concessions and land may not be readily available for purchase, not only for economic but also for political reasons. Firms from the host economy must be willing to cooperate with emerging multinationals or be available as a target for an acquisition. Overseas subsidiaries have to make profits before they can generate financial returns.

Even though it has been suggested above that the possession of ownership advantages may not be a necessary prerequisite for successful overseas investment (Driffield & Love, 2003; Fosfuri & Motta, 1999), the generation of certain types of returns from OFDI does require the prevalence of sufficient absorptive and learning capacity at both the level of the less advanced economy and its firms. At the level of the economy, absorptive capacity requires an appropriate institutional and legal environment in the home country, supportive policy-making, a solid level of education and technological skills, sufficient quality of domestic labour and other economic and legal fundamentals (Mowery & Oxley, 1995; World Bank, 2008). At the level of the firm, absorptive capacity requires the possession of prior related knowledge, providing a firm with the ability to ‘recognize the value of new, external information, assimilate it, and apply it to commercial ends’ (Cohen & Levinthal, 1990, p. 128).

Firm-level absorptive capacity is particularly important for the generation of intangible capability_(transfers) returns, allowing know-how transferred from overseas, in tacit or explicit form, to be effectively recognised, assimilated and applied. Makino et al. (2002), for example, found that successful asset-seeking FDI by Taiwanese firms was contingent on the investing firm’s possession of technological capabilities or prior experience in strategic asset-seeking. Firm-level absorptive capacity is, however, only effective if there is absorptive capacity at the country level as well. The latter is also necessary for the generation of intangible capability_(upgrading) returns, as enhancing the quality of a nation’s workforce requires the necessary institutional and educational environment. If less advanced economies or their firms lack the necessary absorptive capacity, these types of returns may not be effectively realised. For the generation of financial returns, it is even necessary for countries and their firms to have a good degree of competitiveness in order to access overseas markets and engage in efficient production abroad.

Finally, there may be hurdles in the establishment of the links between home and host economies necessary for the realisation of returns. This includes limitations to cross-border financial transfers and transport of commodities and capital goods. Processes of exchange and know-how-sharing from target companies and subsidiaries to headquarters must work effectively in order to exchange expertise and know-how which is often intrinsically connected to the institutional structures of a firm and may be ‘tacit, socially complex, and idiosyncratic’ (Ranft & Lord, 2002, p. 423). While a firm as a social community provides a suitable environment for quick and efficient creation and transfer of knowledge (Kogut & Zander, 1996), for knowledge effectively to reach the parent company, positive interaction and trust must be maintained between it and its subsidiaries along structural, relational and cognitive dimensions of social capital (Nahapiet & Ghoshal, 1997, 1998; Tsai & Ghoshal, 1998). Many Chinese firms have acquired technological leaders in advanced economies, without interfering in the organisational structure of the acquired firms (Knoerich, 2010) – a ‘light-touch’ approach which minimises social interaction and may impede learning.

Certainly not all of the activities associated with MNEs’ outward investment are by nature good for home economies – especially when capital outflows and ‘offshoring’ are the result – but many of the benefits the returns from OFDI can bring are shared widely and beyond the narrow realm of the investing MNE. It is rather the above limitations in the realisation of effective returns from OFDI which may form the primary inhibitors of a development contribution.

4.2. Comparison with other international channels of economic interaction

Beyond weighing the strengths of OFDI in contributing to economic development against its limitations, the significance of OFDI for economic development should also be judged by comparing it with the strengths and weaknesses of other international economic activities found in past research

to make a development contribution: direct capital inflows from abroad, the international exchange of goods and services, and the movement of people across borders (Andreosso-O'Callaghan & Qian, 1999; World Bank, 2008; Saggi, 2004). While each of these makes a distinct contribution to economic development, they all have their own limitations and necessary prerequisites.

The rich literature on the effects of *inward* FDI on economic growth and development, for instance, itself remains inconclusive and ambiguous, both theoretically and empirically (Crespo & Fontoura, 2007; Fan, 2003; Moran et al., 2005; Narula & Dunning, 2000, 2010; Saggi, 2002; Shan, Tian, & Sun, 1999; Sornarajah, 2004; Young & Lan, 1997). While inward FDI brings in fresh capital and may have a positive impact by creating employment, enhancing tax revenues, expanding trade, generating spillovers and transferring know-how, it is typically followed by capital outflows when companies repatriate profits back to the home country. Moreover, foreign investors often employ expatriates in key positions and transfer dated and unsuitable technologies to less advanced host economies (Sornarajah, 2004), limiting development opportunities. Spillover effects in host economies may be constrained by similar deficiencies in absorptive capacity and limitations to inter-firm collaboration, and the foreign competition may put domestic firms out of business. Meyer suggests that the net effect of inward FDI in host economies may be 'close to nil' (Meyer, 2005, p. 7).

Imports can mitigate capacity problems and bring in much-needed capital goods and high-tech products which cannot be manufactured domestically. However, import prices can be volatile, and the technology gains from imports are limited by the difficulties of deciphering tacit or non-codified elements of products through unilateral activities such as reverse engineering. An export-oriented development strategy can increase employment and yield enhanced earnings and foreign exchange. But tough foreign competition can significantly limit the gains from such a strategy. Licensing agreements and original equipment manufacturing for exports offer potential learning opportunities, but such arrangements only work when companies outsourcing production via a license are comfortable sharing the relevant technologies with firms in less advanced economies, which applies more often to less sophisticated technologies with lesser proprietary value.

Outward migration offers gains from remittances and the prospect of well-educated returnees in the future, but the departure of key talent – the so-called 'brain drain' – can be a significant burden (Adams, 2003; Docquier, 2006; World Bank, 2008). It remains an open question as to what extent migrants carry or transfer complex and tacit know-how back to the home country for effective use in domestic industries. Finally, high-skilled immigrants from advanced economies rarely settle in lower-income countries, preventing the latter from reaping the benefits of immigration.

In sum, inward FDI, trade and migration make important contributions to economic development. But as they have also faced limitations and constraints, the returns from OFDI have their own distinct role to play, deserving separate, explicit consideration in research and economic policy. In fact, there are unique development contributions which only OFDI can make, complementing inward FDI, trade and migration. This is because OFDI offers one unique attribute not held by the others – the corporate ownership of non-financial overseas assets. Only OFDI can provide secure and stable access to natural resources and commodities and offer opportunities to access particular assets which are only available abroad, such as certain technologies and brands. In contrast to inward FDI, OFDI places the responsibility for development outcomes into the hands of the firms from the less advanced economies themselves. It is they who have to determine appropriate investment locations (such as in advanced economies or in the vicinity of technological leaders); to decide on the entry mode suitable to the type of asset or advantage pursued; to choose appropriate foreign companies for acquisition; and to consider strategies on how to seek and transfer desired technologies and know-how, possibly the ones most suitable for production conditions in the less advanced home economy and compatible with indigenous technologies there. With firms from less advanced economies themselves having to be pro-active and in control of the process, the prospects of gaining access and transferring those capabilities and resources considered important for development are likely to be heightened. Naturally, there is a price to pay for this control, as the financial burden and investment risk resulting from the liability of foreignness (Child & Rodrigues, 2005; Tang, Gao, & Li, 2008; Zaheer, 1995) can be substantial for firms from less advanced economies.

5. Conclusions

This study investigated how OFDI contributes to economic development in the world's less advanced home countries. Drawing on a variety of theoretical and empirical evidence together with specific examples, it found that multinational enterprises generate returns when they pursue assets and advantages abroad through OFDI. In various ways, these financial, intangible capability and tangible capacity returns help ease a country's development needs, such as by bringing in additional finance, supporting industrial growth and technological catch-up, enhancing production capacities, and providing stability needed to support the development process.

It is those countries at the later stages of economic development, such as the emerging economies, which should experience the largest gains from OFDI. This is because their endowment with capital, absorptive capacity and international exposure is considerable, while important development needs persist. Emerging economies potentially receive the largest variety of returns from OFDI as their firms – in contrast to firms from high-income and other lower-income economies – have the options to invest in more advanced, equal and less advanced economies. While advanced economy OFDI also generates a variety of returns, it is less able to provide a specific development contribution to the home economy, such as by narrowing knowledge gaps vis-à-vis the international technology frontier or by providing much-needed finance, capital goods or resources to support a process of industrialisation. Low-income countries, in turn, are severely constrained by the lack of investment capital and small number of multinational enterprises, so they are much less likely to benefit in significant ways from OFDI. Nevertheless, companies from countries such as Indonesia (Lecraw, 1993) and China (Young, Huang, & McDermott, 1996) already invested abroad at times when they had not yet reached the status of emerging economies, and lower-income countries may still reap some development gains from individual OFDI projects.

This study acknowledged a number of limitations to the potential development contribution of OFDI. There is a lack of clarity, however, on the severity of these constraints, and similar limitations have also been found in studies of other economic phenomena and international economic exchanges which are purported to have a positive impact on economic development. Some types of OFDI will contribute to home economy development more than others.

More certain is the urgent need for more research on the returns from OFDI. Such research should provide more detailed assessments of the types of OFDI activity which produce more, or less, beneficial development outcomes. This can be done, for example, by analysing what assets and advantages generate which kinds of returns, how effective these returns are in facilitating home economy development in particular ways, what mechanisms, conditions, company strategies and government policies are supportive to this process, to what degree 'reverse' spillovers and knowledge diffusion mechanisms as well as benefits to home economy suppliers are being realised, and when returns are generated on a time trajectory after the initial investment was made. Do only the large acquisitions or major investment deals have a significant impact, or can small-scale R&D activities, for instance, yield positive results for development as well, enabling poorer countries with less capital availability to enjoy some of the potential benefits offered by OFDI? These kinds of questions require further attention in future research.

A more precise understanding of how OFDI contributes to economic development would enable governments to identify what kinds of policies and incentives as well as institutional and legal frameworks best promote OFDI in the interest of development. Policy should aim at supporting OFDI in areas proved to provide a development benefit to the national economy, such as where OFDI mitigates constraints, shortages and bottlenecks typically experienced by developing countries. Because different types of OFDI promote home economy development in different ways, a selective policy and incentive framework is needed. For example, based on the findings of this study, a policy framework might promote OFDI which promises to generate intangible capability_(transfers) and tangible capacity returns, especially in sectors of strategic importance to the home economy. Policy should curtail any outright negative effects, and encourage OFDI which avoids crowding out domestic investment or

economic activity, such as where financial and intangible capability_(upgrading) returns might be expected in the short- to medium-term.

Governments from advanced economies could consider providing assistance or subsidies for FDI originating from less advanced economies if it addresses development needs of the home economy in such areas as agriculture, the environment, pharmaceutical research or other sectors relevant to development. In such a context, advanced economies have an opportunity to contribute to global development through an additional channel, namely, by hosting targeted investors from less advanced economies.

A key contribution of this study is to highlight this issue as an important but so far much neglected dimension in current research on FDI and development. OFDI needs more explicit consideration in the development literature. It is hoped that the categories introduced in this study provide a useful framework for further inquiries into this area. They may also function as a source of guidance for policymakers concerned with issues of economic development.

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