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Outward Foreign Direct Investment to the Natural Resource Sectors by Global Public Investors from Emerging Economies: Trends, Causes, Effects

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Abstract

Foreign direct investment impacts economies around the world, and it influences the nature of the global economy. Foreign direct investment affects the pattern of business activity around the world, and helps to shape economic growth and development globally.

Today the patterns of foreign direct investment are shifting. As a result, dynamics are different. The causes and effects are changing. So far, understanding and responding to the shifting nature of global foreign direct investment has been disjointed.

Over the last six years, developing and transition economies have become a significant source of outward foreign direct investment. Outward foreign direct investment allocated towards the natural resource sectors from key emerging economy state-owned enterprises and sovereign wealth funds contributes significantly to the shift and increase in outward foreign direct investment from key emerging economies.

This paper seeks to better understand this trend and identify the firm-level causes, and subsequently the economic, geopolitical, and political effects resulting from these causes. Government control, over emerging economy state owned enterprises and sovereign wealth funds, provides specific political ownership advantages that make outward FDI successful. An important cause and effect of this success is international political cooperation.

Declaration

This master thesis has been written in partial fulfillment of the Master of International Law and Economics Program at the World Trade Institute. The ideas and opinions expressed in this paper are made independently, represent my own views and are based on my own research. I confirm that this work is my own and has not been submitted for academic credit in any other subject or course. I have acknowledged all material and sources used in this paper.

Table of Contents

List of Abbreviations

AUM	Assets Under Management
BRIC	Brazil, Russia, India, China
FDI	Foreign Direct Investment
GCC	Gulf Cooperation Council
GPI	Global Public Investor
SOE	State Owned Enterprise
SWF	Sovereign Wealth Fund

Introduction

Developing and transition countries have recently emerged as major global economic influences. The nature of their influence is the subject of furious research and debate. As a group, emerging economies exhibit a particular kindred trend. Developing and transition economies are now growing to become a substantial and increasing source of outward foreign direct investment (FDI). Over the last six years in particular, developing and transition economies have generated record levels of FDI outflows.[1] The growing importance of FDI outflows from emerging economies to the development of economies around the world is now undeniable.[2]

Over the last six years, outward FDI to the natural resource sectors and outward FDI from key developing and transition economies, have both concomitantly exhibited substantial relative strength.[3] In addition, emerging economy governments control significant portions of FDI outflows to the natural resource sectors. The internationalization of large global public investors (GPIs)[4] both, state-owned enterprises (SOEs) and sovereign wealth funds (SWFs), from emerging economies, now constitute an important global component of outward FDI. [5]

The many impacts of this recent global economic force are still uncertain. Fundamental and defining characteristics are still waiting to be uncovered, unpacked, and understood. To understand the effects of this recent trend, succinct questions must be asked, and new analyses must respond.

This paper is based on three questions: (1) Is this trend significant, what are the component facts that underlie this recent and resurgent trend? (2) What are the likely causes of this new phenomenon, and what causes can be gleaned from the component facts? (3) What effects are evident from an analysis of the facts and the causes?

This paper grounds the analysis of outward FDI from emerging economies in two observations: (1) Developing and transition economies exhibit a growing demand for natural resources. (2) They concomitantly maintain centralized government control over natural resource-based multinational enterprise (MNE) behavior and FDI activity.

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[1] UNCTAD, 'Non-Equity Modes of International Production and Development, Annex table I.1 ', *World Investment Report*, New, York and Geneva: 2011, pp. 187-190. And from, UNCTADstat, available at, <www.unctadstat.unctad.org>

[2] UNCTAD, 'Non-Equity Modes of International Production and Development', *World Investment Report*, New York and Geneva: 2011, p. xii.

[3] Ibid.

[4] The term 'global public investor' is used by West et al. to include, "sovereign wealth funds, foreign state managed social security plans, foreign currency reserve funds, foreign government employee pension funds, state controlled operating companies and other foreign investing vehicles." I use it to conjure only SOEs and SWFs. West, D. Kimball, R. Nathoo, R. Zwirn, D. Ramachandran, V. Goldstein, G. Moser, J. 'Rebuilding America: The Role of Foreign Capital and Global Public Investors', *Governance Studies at Brookings*, March 11, 2011.

[5] UNCTAD 2011, see note 2 at p. 28.

This paper analyzes outward FDI trends by maintaining a very specific focus. Chapter 1 begins with an analysis of the recent state of global FDI outflows, before progressing with an in-depth analysis of FDI outflows from key emerging economies. Of particular interest is the rise in outward FDI from emerging economies directed towards the natural resource sectors. The focus of emerging economy analysis is predominantly, although not exclusively, represented by, Brazil, Russia, India, and China (BRICs). To varying degrees, these economies all have recently displayed growing outward FDI in the natural resource sectors by home country GPIs. Indeed, these countries all show a preference for government control of natural resource-based FDI.

Chapter 1 shows that the growth of outward FDI allocated towards the natural resource sectors over the last five years from emerging economies is truly remarkable relative to overall global outward FDI trends. Given the relative and absolute size of the shift towards outward FDI directed at the natural resource sectors from developing and transition economies, chapter 1 concludes that no one factor alone is driving this shift.

Chapter 2 sets out to describe the global and regional prominence of GPIs and their outward FDI in the natural resource sectors. Following from the conclusion of the first chapter, SOEs and SWFs are described as the source of significant outward FDI from emerging economies. Transitioning to the third chapter it becomes clear that GPIs represent a large portion of emerging economy outward FDI that is driven by more than just commercial objectives. Chapter 2 sets the stage for the paper's first pivotal contention. This paper stresses that SOEs and SWFs are significant vehicles of emerging economy outward FDI in the natural resource sectors and that this investment is characterized by a blend of motivations because it is government controlled.

Chapter 3 applies theoretical tools developed by Dunning's Eclectic Paradigm to explain the firm-level causes of the increase in the trend unpacked in chapters 1 and 2. A firm-level analysis reveals that GPI-specific political ownership advantages determine the firm-level causes of GPI behavior and outward FDI activity.

While chapter 3 does acknowledge that economic expansion and commercial objectives help to determine GPI behavior and FDI activity in the natural resource sectors, a firm-level analysis identifies four politically driven reasons that GPIs make the move to internalize foreign operations within the firm, as opposed to buying and selling via market transactions. The reasons include, (1) political management advantages, (2) unique access to political information advantages, (3) political leverage advantages, and (4) the advantages of unique access to government financing.

The argument follows from a critical distinction between the advantages that governments provide to MNEs and the advantages that GPIs receive as a direct result of government ownership. To be sure, many MNEs benefit from government support of all kinds, but

government ownership provides unique advantages to GPIs. Chapter 3 concludes that political ownership advantages significantly contribute to the confluent body of factors behind the current expansion of outward FDI from emerging economies.

Chapter 3 does not contend that a firm-level analysis describes *all* of the causes of outward FDI to the natural resource sectors by emerging economies.

Chapter 4 explores the effects of this new trend by briefly discussing the likely economic distortions and geopolitical effects, before concluding that because of the political causes, the effects must lead to increased international political cooperation and less economic protectionism.

The increase in outward FDI from developing and transition economies is indeed significant. The facts point to increased interest in natural resource sector investment by government controlled SOEs and SWFs. Government control creates and exploits GPI-specific political ownership advantages. The GPI-specific political advantages that a firm-level analysis delineates are a significant cause of the recent increase in government controlled outward FDI to the natural resource sectors. The facts and causes of this trend highlight the cooperation that governments utilize and rely upon for outward FDI successes. Because cooperation is a fundamental element of GPI behavior and FDI activity, responding to the shifting nature of global FDI flows must focus tirelessly on facilitating international investment cooperation between all countries.

Clarification of Terms

The definition of FDI used throughout this paper relies on the definition provided by the Organization for Economic Co-operation and Development (OECD): "A category of investment that reflects the objective of establishing a lasting interest by a resident enterprise in one economy (direct investor) in an enterprise (direct investment enterprise) that is resident in an economy other than that of the direct investor. The lasting interest implies the existence of a long-term relationship between the direct investor and the direct investment enterprise and a significant degree of influence on the management of the enterprise. The direct or indirect ownership of 10% or more of the voting power of an enterprise resident in one economy by an investor resident in another economy is evidence of such a relationship."[6] FDI outflows are international investments measured from the origins or source of the investment as opposed to

[6] OECD, 'Glossary of Foreign Direct Investment Terms and Definitions', *OECD Benchmark Definition of Foreign Direct Investment,* Paris, April 2008 p 3. The term 'global public investor' is used by West et al to include, "sovereign wealth funds, foreign state managed social security plans, foreign currency reserve funds, foreign government employee pension funds, state controlled operating companies and other foreign investing vehicles", West, D. Kimball, R. Nathoo, R. Zwirn, D. Ramachandran, V. Goldstein, G. Moser, J. 'Rebuilding America: The Role of Foreign Capital and Global Public Investors', *Governance Studies at Brookings,* March 11, 2011.

the destination. Throughout this paper, FDI outflows are synonymous with outward FDI. Reference to FDI outflows is measured on a yearly basis unless otherwise specified.

In addition, for the purposes of this essay, outward FDI by GPIs is synonymous with outward FDI by SOEs and SWFs. The many references in this paper to 'GPIs', is specifically intended to describe the nature of government-control in both SOEs and SWFs. For the purposes of the proceeding discussion this essay will focus on the similarities between the two types of government-influenced international investors. Defending the merits for a co-analysis of SOEs and SWFs, despite their differences, will be given in more detail.

The term 'natural resource sectors' is meant as a relatively broad reference to industries in the primary sector and related industries. The primary sector is; mining, quarrying and petroleum; as categorized by the United Nations Conference on Trade and Development (UNCTAD). Natural resource related industries often categorized within manufacturing include, metal and metal products. Where other definitions are intended, they will be specified. The proceeding analysis focuses primarily on the extractive industries within the primary sector, therefore, any reference to the natural resource sectors is not meant to conjure, agriculture, hunting, forestry or fishing, unless indicated otherwise. The definitions used in this essay are necessitated by the disparate definitions countries use to disclose FDI information. The analysis cannot best be served by adhering to one confined definition of natural resources.

Reference to emerging economies, or emerging economy FDI outflows, is synonymous with developing and transition economies and their outflows. Developing and transition economies are all non-developed countries unless otherwise specified.

1. Recent Trends in Outward FDI

Chapter one details the recent trends in global and regional outward FDI activity and targets specifically an analysis of the recent outward FDI directed at the natural resource sectors. Progressing from a global overview to a regional and BRIC country snapshot, this chapter shows the substantial strength of emerging economy outward FDI directed towards the natural resource sectors over the last six years.

1.1 The Global Complexion of FDI Outflows

Global FDI outflows measured on an annual basis, between 2005 and 2010, first grew to record levels in 2007, before declining substantially during the recent depths of the financial and economic crisis in 2008 and 2009. Global FDI outflows recovered modestly in 2010. Global FDI outflows totaled $882 billion in 2005, $1.41 trillion in 2006, $2.17 trillion in 2007, $1.91 trillion in 2008, $1.17 trillion in 2009, and $1.32 trillion in 2010.[7]

[7] UNCTAD 2011, see note 1 at Annex table I.1 pp. 187-190.

In addition, the annual value of global cross-border M&A net purchases in all sectors and industries between 2005 and 2010 were, $462 billion in 2005, $625 billion in 2006, $1 trillion in 2007, $707 billion in 2008, $250 billion in 2009, and $339 billion in 2010.[8] Furthermore, the annual value of global, "world as source",[9] greenfield FDI projects in all sectors and industries between 2005 and 2010 were, $710 billion in 2005, $884 billion in 2006, $940 billion in 2007, $1.46 trillion in 2008, $952 billion in 2009, and $807 billion in 2010.[10]

UNCTAD projects that global FDI flows will reach $1.5 trillion by the end of 2011, $1.7 trillion in 2012, and 1.9 trillion in 2013.[11] However, they also note that these forecasts are based largely on a financial and economic global recovery and only without any further financial and economic shocks will FDI flows rebound and recover to pre-crisis levels in the next two years.[12] On June 17, 2011, the International Monetary Fund (IMF) issued an update to its own economic outlook that notes the recent increase in global economic downside risks, and the continuing unbalanced environment of global economic expansion.[13]

The financial and economic global recovery still faces considerable challenges, and economic growth around the world remains unbalanced. It is likely that overall global FDI outflows will remain erratic in the near-term. It is therefore important to identify and analyze growing and evolving particular FDI trends that are likely to emerge and outperform throughout the ongoing global financial and economic crisis. Emerging trends will have a disproportionate impact on the environment for economic growth and development around the world.

1.2 Global FDI Outflows Destined for Natural Resource Sectors are Increasing

In the 19th century, rapidly industrializing economies, from North America and Europe, pushed to expand outward FDI into the natural resources related industries all around the world. Before World War II, natural resources FDI accounted for roughly 60% of the cumulative international capital stock.[14] Jump ahead to 1990, and the natural resources sector, more specifically, the primary sector, totaled only 10% of FDI stock. And 15% of that total was hosted by developing countries. However, 15 years later, in 2004, the share of primary sector FDI capital stock hosted by developing countries doubled to roughly 30%.[15] Today, natural

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[8] UNCTAD 2011, see note 1 at Annex table I.3 pp. 195-198.
[9] As a note, 'world as sourcec' is how UNCTAD categorizes the direction of greenfield investment. 'World as source' indicates outward greenfield FDI. UNCTAD, 'Non-Equity Modes of International Production and Development, Annex table I.8', *World Investment Report*, New York and Geneva: 2011, pp. 206-209.
[10] UNCTAD 2011 see note 1 at Annex table I.8 pp. 206-209.
[11] UNCTAD 2011, see note 2 at p. xii.
[12] UNCTAD 2011, see note 2 at p. iii.
[13] International Monetary Fund, 'World Economic Outlook Update, An update of the key WEO projections, Mild Slowdown of the Global Expansion, and Increasing Risks', Washington DC: *International Monetary Fund Outlook*, June 2011. in its entirety.
[14] Dunning, J., Lundan, S. *Multinational Enterprises and the Global Economy*, Cheltenham, UK: Edward Elgar Publishing Limited, 2008, (2nd edn.), 2008, p. 69.
[15] Ibid.

resource outward FDI from all parts of the globe, often targeting developing economies, has continued to increase from 2004 levels.

Over the last 5 and 10 years, there has been a concomitant and significant increase in FDI flows to the natural resources sector and the sector's share of FDI outflows globally.[16] Outward FDI destined for the natural resources sectors, particularly the extractive industries, increased slowly between 2000 and 2005. The increase at the early part of the new century came from new greenfield investments in oil, gas, metals, mineral exploration and extraction, and from an increasing number of large cross-border M&As.[17] This trend, has accelerated between 2005 and 2010.

Annual cross-border M&A *net* purchases in the primary sector; mining, quarrying and petroleum; between 2005 and 2010 globally, increased from less than $3 billion in 2005 which accounted for less than 1% of cross-border net purchases in all sectors combined, to $52 billion in 2010, which accounted for 15% of the total cross-border net purchases in all sectors globally.[18]

Furthermore, in the first 5 months of 2011, mining, quarrying, and petroleum activity is on pace to increase its share of the global cross-border M&A activity, with an estimated 17% of the global total.[19] Compared to the overall trends in global FDI outflows, and specifically global M&A net purchases, cross-border M&A net purchases in the primary sector have exhibited absolute strength over five and six year periods, and consistent relative strength on a yearly basis.[20]

The value of natural resource FDI projects, including cross-border M&A and greenfield investments, reached a total of $254 billion in 2010, giving the primary sector a 22% global share of total FDI. This is an increase from 14%, where the sector's share was in 2007 before the onset of the financial and economic crisis.[21] By contrast, during this same period, overall global FDI declined, and investment flows to many sectors and industries displayed similar decreasing patterns.

1.3 The Complexion of Developing and Transition Economy FDI Outflows

While the overall global trend of FDI outflows has been erratic over the last six years, first reaching record levels before contracting during the financial and economic crisis, the share of

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[16] UNCTAD, 'Transnational Corporations, and the Infrastructure Challenge', *World Investment Report*, 2008, p. 9.
[17] UNCTAD, 'Transnational Corporations, Extractive Industries and Development', *World Investment Report*, 2007, p. xvi.
[18] UNCTAD 2011, see note 1 at Annex table I.5 p. 203.
[19] Ibid.
[20] As a note, over the last six years UNCTAD has switched from reporting cross-border M&A purchases on an 'absolute' basis in 2005, to a 'net' basis in 2010. UNCTAD reported cross-border M&A net purchase consistent time-series data for the last six years in its 2011 *World Investment Report*, which conveys the data on a consistent *net* basis.
[21] UNCTAD 2011, see note 2 at p. 10.

global FDI annual outflows from developing and transition economies has been steadily increasing since 2003,[22] and reached record levels in 2010.[23]

In 2005, FDI outflows from developing and transition economies reached $136 billion, 15% of the global total. In 2010, FDI outflows from emerging economies reached their highest levels ever at $389 billion, and increased their global share to 29%.[24]

In addition, the relative outperformance of annual FDI outflows from developing and transition economies during the depths of the financial and economic crisis is striking. In 2008, at the onset of the current crisis, FDI outflows from emerging economies increased by 6% from 2007 levels, while FDI outflows from developed economies *declined* by 16% from 2007 levels.[25] In 2009, at the recent depths of the crisis, FDI outflows from developing and transition economies proved much more resilient than their developed economy counterparts,[26] declining by 13% from 2008 levels, while FDI outflows from developed economies declined by 45% from 2008 levels.[27] In 2010 FDI outflows from developed economies totaled $935 billion, roughly half of the 2007 $1.83 trillion peak. By contrast, developing and transition economy FDI outflows totaled $389 billion in 2010, an all-time high, and 12% above their 2007 level of $346 billion.[28]

To be sure, developing and transition economies are many, diverse, and at different stages of economic development.[29] However, in 2010 the share of the top 21 developing and transition economies, together accounted for $346 billion, or 88% of the total annual FDI outflows from all 174 developing and transition economies combined, and 26% of the global total.[30] Of the 21 emerging economy leaders, a smaller group of four countries stands out and has garnered much attention for its outsized contribution to the shift in global FDI trends.[31] The BRICs as a group are emerging as strong FDI source economies.[32] The BRICs have increased their outward FDI markedly since 2000, fairing especially well during the financial and economic crisis.[33]

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[22] UNCTAD 2007, see note 17 at p. 33.
[23] UNCTAD 2011, see note 1 at Annex table I.1 pp. 187-190.
[24] Ibid.
[25] Ibid.
[26] UNCTAD, 'Investing in a Low-Carbon Economy', *World Investment Report*, 2010, p xix.
[27] UNCTAD 2011, see note 1 at Annex table I.1 pp. 187-190.
[28] Ibid.
[29] Economou, P. Sauvant, K. '*From the FDI Triad to multiple FDI poles?', Columbia FDI Perspectives: Perspectives on topical foreign direct investment issues.* New York, NY: The Vale Columbia Center on Sustainable International Investment, No. 42 July 18, 2011, p. 1.
[30] As a note, 174 is the number of developing and transition economies reported by UNCTAD. see, UNCTAD, 'Non-Equity Modes of International Production and Development, Annex table I.1', *World Investment Report*, 2011, pp. 187-190.
[31] Sauvant, K. Maschek, W. McAllister, G 'Foreign Direct Investment by Emerging Market Multinational Enterprises, the Impact of the Financial Crisis and Recession, and Challenges Ahead', in Sauvant, K. Maschek, W. McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, New York, NY: Palgrave MacMillan, 2010, p. 10.
[32] Economou, P. Sauvant, K. see note 29 at p. 1.
[33] Sauvant, K. Maschek, W. McAllister, G, see note 31 at p. 10.

In 2010 the BRIC countries' FDI outflows (excluding Hong Kong, China and Macao, China) totaled $146 billion. This represents 42% of all developing and transition economy annual FDI outflows, and 11% of global FDI outflows.[34] The recent increase from the BRICs is evidenced by the fact that in 2005 their cumulative FDI outflow total was $31 billion, 3.5% of global FDI outflows. In 2000 the BRIC's total was $7 billion, less than one percent of global FDI outflows.

1.3.1 Brazilian FDI Outflows Are Increasing

Brazilian FDI annual outflows have increased from $2.2 billion in 2000 to $2.5 billion in 2005 and further to $11.5 billion in 2010.[35] Brazilian FDI outflows in 2010 amounted to 15% of the forty three-country, Latin America and the Caribbean region's total. 15% is an increase from 7% in 2005.[36] Brazil is perennially one of the top sources of FDI outflows from the region.[37] In addition, in 2010 cross-border M&A net purchases by Brazilian companies totaled $7.8 billion, an increase from $2.5 billion in 2005. In 2010, Brazilian MNEs accounted for 50% of the region's overall M&A purchases, in 2005 they accounted for only 25% of the total.[38]

Furthermore, the value of greenfield FDI projects from Brazil destined to the rest of the world totaled $8.8 billion in 2010, up from $3.2 billion in 2005.[39] These figures exhibit substantial FDI outflow increases from Brazil recently, albeit it is notable that Brazilian FDI outflows are less consistent on a yearly basis. While the increasing trajectory is clear, over the last 10 years FDI outflows from Brazil have been erratic year to year.[40]

1.3.2 Russian FDI Outflows Are Increasing

Russian FDI annual outflows have increased from $3.2 billion in 2000, to $12.8 billion in 2005, and further to $51.7 billion in 2010.[41] Russia's share of *global* FDI outflows increased from a fraction of 1% in 2000, to 1.5% in 2005, and further to 4% in 2010.[42] Since 2007, annual Russian FDI outflows have been in an elevated range between $45 billion and $55 billion. 2007 marked the year that Russian FDI outflows doubled from any previous yearly totals.[43] Cross-border M&A net purchases in 2010, by Russian companies abroad were $9 billion, up from $6 billion in 2005.[44]

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[34] UNCTAD 2011, see note 1 at Annex table I.1 pp. 187-190.
[35] Ibid.
[36] Ibid.
[37] Resende, P. Almeida, A. Ramsey, J. 'The Transnationalization of Brazilian Companies: Lessons from the Top Twenty Multinational Enterprises', in Sauvant, K. Maschek, W. McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead,* New York, NY: Palgrave MacMillan, 2010, pp. 97-111.
[38] UNCTAD 2011, see note 1 at Annex table I.3 pp. 195-198.
[39] UNCTAD 2011, see note 1 at Annex table I.8 pp. 206-209.
[40] UNCTAD 2011, see note 1 at Annex table I.1 pp. 187-190.
[41] Ibid.
[42] Ibid.
[43] Ibid.
[44] UNCTAD 2011, see note 1 at Annex table I.3 pp. 195-198.

Furthermore, greenfield FDI projects from Russia destined to the rest of the world totaled $13.6 billion in 2010, marking a decline from the record amount of $25.4 billion in 2005, but up 14% compared to 2009 levels.[45] Outward FDI flows from Russia rose by 24% in 2010 from 2009 levels of cross-border M&A purchases rose in 2010 from 2009 levels.[46] These figures exhibit a recent trend of substantial FDI outflow increases from Russia.

1.3.3 Indian FDI Outflows Are Increasing

Indian FDI annual outflows have increased from $514 *million* in 2000, to $3 billion in 2005, and further to $14.5 billion in 2010.[47] Indian FDI outflows in 2010 amounted to 6% of the region's total. 6% is an increase from 4% in 2005.[48] India is grouped by UNCTAD in the power-house-packed, twenty-nine country; South, East, and South-East Asia region. This region includes countries such as China, Hong Kong China, Taiwan, Korea, Malaysia, and Vietnam.[49]

During 2010, cross-border M&A net purchases by Indian companies abroad totaled $26.5 billion, an increase from $1.9 billion in 2005. During 2010 Indian MNEs accounted for 28% of the entire region's total value of M&A purchases, and 8% of the global total. In 2005 Indian MNE net purchases accounted for only 8% of the region's total and only a fraction of 1% of the global total.[50]

Furthermore, greenfield FDI projects from India destined to the rest of the world totaled $17.3 billion in 2010, up from $11.2 billion in 2005.[51] $17.3 billion represents 12% of the region's total outward greenfield investment.[52] These figures of Indian outward FDI activity also exhibit a recent upward trend of substantial FDI increases.

1.3.4 Chinese FDI Outflows Are Increasing

Chinese FDI outflows have increased from, $915 *million* in 2000, to $12.3 billion in 2005, and further to $68 billion in 2010.[53] In 2010, Chinese FDI outflows amounted to 40% of the; South, East, and South-East Asia region's total FDI outflows.[54] China's share of global FDI outflows increased from a fraction of 1% in 2000, to 1.5% in 2005, and further to 5% in 2010.[55] Annual Chinese FDI outflows have increased substantially and steadily every year since 2002.[56]

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[45] UNCTAD 2011, see note 1 at Annex table I.8 pp. 206-209.
[46] UNCTAD 2011, see note 2 at p. 65.
[47] UNCTAD 2011, see note 1 at Annex table I.1 pp. 187-194.
[48] Ibid.
[49] Ibid.
[50] UNCTAD 2011, see note 1 at Annex table I.3 pp. 195-198.
[51] UNCTAD 2011, see note 1 at Annex table I.8 pp. 206-209.
[52] Ibid.
[53] UNCTAD 2011, see note 1 at Annex table I.1 pp. 187-190.
[54] Ibid.
[55] Ibid.
[56] Ibid.

Cross-border M&A net purchases in 2010 by Chinese MNEs were $29.2 billion, up from $3.7 billion in 2005.[57] In 2010, Chinese MNE cross-border M&A purchases accounted for 8.6% of the global total, an increase from under 1% in 2005.[58] Greenfield FDI projects from Chinese MNEs destined to the rest of the world totaled $29.2 billion in 2010, marking a sharp increase from $9.8 billion in 2005.[59] In 2010, Chinese greenfield FDI projects abroad accounted for 3.6% of all the global greenfield projects, an increase from 1.3% in 2005.[60] These figures exhibit a recent trend of substantial annual FDI outflow increases from China.

1.4 Outward Natural Resources FDI from Emerging Economy MNEs is Increasing

Data to measure the rate of increase in FDI outflows to the natural resource sectors from key emerging economy sources is fraught with gaps and inconsistencies. That is to say, country data is not disaggregated and calculation methods have changed. However, UNCTAD provides global and regional figures for cross-border M&A purchases in the primary sector; mining, quarrying and petroleum; in both 2005 and 2010. Therefore, an illustrative comparison can be made between the shares of developed versus developing country data in 2005 and again in 2010.[61]

The analysis will proceed by presenting yearly regional figures for primary sector cross-border purchases from; Latin American, and the Caribbean; South-East Europe, and the Commonwealth of Independent States; South, East, and South-East Asia; and West Asia, respectively.

In each section, the statistical groundwork provides a basis with which to pursue a descriptive analysis of the BRIC countries as representatives of their respective regions. The global trajectory over the last six years is revealing. UNCTAD reported that in 2005, developed countries accounted for $98 billion dollars of all the cross-border M&A purchases in the primary sector; mining quarrying and petroleum; which globally totaled $105 billion dollars.[62] In other words, 93% of all cross-border M&A purchases in mining, quarrying and petroleum globally, came from developed country MNEs. In addition, $98 billion dollars was 14% of all cross-

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[57] UNCTAD 2011, see note 1 at Annex table I.3 pp. 195-198.
[58] Ibid.
[59] UNCTAD 2011, see note 1 at Annex table I.8 pp. 206-209.
[60] Ibid.
[61] As a note, to reiterate, yearly cross-border M&A statistics have been compiled and reported by UNCTAD have changed over the last 6 years, from accumulating global and regional purchases in 2005, to global and regional *net* purchases in 2010, which makes an apples-to-apples comparison between 2005 figures and 2010 figures impossible with the data available. Therefore, the 2005 figures are measured against regional 2005 figures and likewise for 2010 data. The respective percentage shares of primary sector activity within each year, 2005 and 2010, can then be informatively compared across the years, on both a regional and global basis. This portion of the analysis is meant as a representation of the overall trend. In addition to the inconsistency of reporting methods, cross-border M&A figures also suffer from reporting distortions, such as outsized deals, reporting gaps, and accounting issues.
[62] UNCTAD 2007, see note 17 at pp. 71. and 278.

border M&A purchase activity in *all sectors* globally.

Developing and transition countries accounted for the remaining 7% of primary sector M&A purchases in 2005. In addition, developing and transition economy primary sector purchases accounted for 1% of M&A purchases in *all sectors* globally.[63]

In 2010, UNCTAD reported that global M&A cross-border *net* purchases in the primary sector; mining, quarrying and petroleum; totaled $52 billion dollars globally. Developed countries accounted for $22.5 billion dollars of the total, or 44%.[64]

Developing and transition countries on the other hand, accounted for $29.5 billion of the cross-border M&A net purchases in the primary sector in 2010, or 56% of the mining, quarrying and petroleum total.[65] Furthermore, in 2010, developed countries primary sector purchases accounted for 6% of all the cross-border M&A activity in *all sectors* globally, while developing and transition countries raised their share to 9%.[66]

Despite data gaps and inconsistencies, which likely mute the severity of this shift in the source and volume of natural resource primary sector cross-border M&A purchases over the last 6 years, the trajectory of change is nonetheless startling.

1.4.1 Latin America and The Caribbean, Regional Primary Sector Purchases Increase: Brazilian FDI Outflows to The Natural Resource Sectors are Increasing

Cross border M&A purchases in the primary sector; mining, quarrying and petroleum, from Latin America and the Caribbean increased from; $881 million, 8.7% of the regions overall M&A total in 2005; to $2 billion, 12.7% of the regions overall M&A activity in 2010.[67] More specifically, FDI in the mining of metal ores increased from $36 billion in 2007, to $46 billion in 2010, and the extraction of crude petroleum and natural gas increased from $1.4 billion in 2007, to $6.3 billion in 2010.[68]

Recently, Brazilian MNEs have been increasing their FDI directed towards the natural resources sector.[69] The recent growth in internationalization by Brazilian firms has been led by FDI in the natural resources sector, primarily commodity-based companies operating in metals, mining, oil, gas, and steel.[70] Natural resource-based MNEs hold approximately two-thirds of the

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[63] Ibid.
[64] UNCTAD 2011, see note 1 at Cross-border M&A Regional Tables pp. 45, 52, 56, 63, 69, and 203.
[65] Ibid.
[66] Ibid.
[67] UNCTAD, 'Transnational Corporations, Extractive Industries and Development, Regional Trends', *World Investment Report*, 2007, p. 55. And, UNCTAD, 'Non-Equity Modes of International Production and Development, Chapter II Regional Investment Trends', *World Investment Report*, 2011, p. 58.
[68] The Central Bank of Brazil, 'Capitais Brasileiros no Exterior, 2007 a 2010', *Banco Central Do Brasil*, 2011, available at, <www4.bcb.gov.br/rex/cbe/port/ResultadoCBE2010.asp>
[69] Sauvant, K. Maschek, W. McAllister, G, see note 31 at p. 11.
[70] Resende, P. Almeida, A. and Ramsey, J., see note 37 at pp. 98-99.

total foreign assets held by the largest Brazilian MNEs.[71]

In 2010 Brazilian companies such as Vale and Petrobras made sizable M&A purchases in, iron ore, steel, and petroleum-refining industries.[72] More specifically, the destination of Brazilian outward FDI by sector show, 8% of the total went to the primary sector, 7% went to metallurgy, 4% went to non-metallic mining, and 4% went to oil derivatives. When all tangential natural resource industries are combined, Brazilian outward FDI in the natural resource sectors totaled 23% in 2010.[73] The recent increases in FDI outflows from Brazil have to a large extent targeted natural resources investments.

1.4.2 South-East Europe and the CIS Regional Primary Sector Purchases Increase: Russian FDI Outflows to Natural Resources are Increasing

Between 2005 and 2010, cross-border M&A purchases from South-East Europe and the CIS, in the primary sector; mining, quarrying and petroleum; progressed from $2 billion in 2005,[74] to $1.8 billion in 2006,[75] to $3.8 billion in 2007,[76] to $3.8 billion in 2008,[77] to $7.9 billion in 2009,[78] to $2 billion in 2010.[79] Moreover, in 2005, 29% of the regions total cross-border M&A purchase activity was in the primary sector. In 2009, due to divestment in other sectors nearly 100% of overall M&A net purchases were in the primary sector. In 2010, the level dropped to 20% of the region's cross-border M&A net purchases were in the primary sector.

In 2010, Russian FDI outflows amounted to 85% of the eighteen-country, South-East Europe and the CIS region's total FDI outflows.[80] Russian MNEs are by far the largest players in the region's increasing FDI outflows, and those operating in natural resource activities control four-fifths of the foreign assets of the top twenty-five Russian MNEs.[81] FDI in the oil, gas, and metals industries are spearheading Russian MNE internationalization.[82] LUKOIL and Gazprom, are the leaders, but other companies too, such as Russian metal companies, have similar

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[71] Ibid.
[72] UNCTAD 2011, see note 2 at pp. 55-56.
[73] ECLAC, 'Foreign Direct Investment in Latin America and the Caribbean, 2010', *United Nations, Economic Commission for Latin America and the Caribbean*, May, 2011, p. 72.
[74] UNCTAD 2007, see note 17 at p. 66.
[75] UNCTAD 2007, see note 17 at p. 66.
[76] UNCTAD, 'Transnational Corporations, Agricultural Productions and Development: Regional Trends,' *World Investment Report*, New York and Geneva: 2009, p. 78.
[77] UNCTAD 2010, see note 26 at p. 50.
[78] UNCTAD 2011, see note 2 at p. 63.
[79] Ibid.
[80] UNCTAD 2011, see note 1 at Annex table I.1 pp. 187-190.
[81] Sauvant, K. Maschek, W. McAllister, G., see note 31 at p. 16.
[82] Kuznetsov, A. 'Outward FDI from Russia and its policy context, update 2011', *Columbia FDI Perspectives: Perspectives on topical foreign direct investment issues*, New York, NY: Vale Columbia Center on Sustainable International Investment, August 2, 2011, p. 2.

influence.[83]

The current expansion of emerging economy MNEs into Africa is represented well by Russian natural resource-based MNEs. For example, the world's largest aluminum producer, RusAl, has expanded operations in Angola, Guinea, Nigeria and South Africa.[84] The global financial and economic crisis is having disparate affects on Russian MNEs. It has forced some to slow their international expansion, while others are realizing new international opportunities.[85] For example, throughout the financial and economic crisis Russian oil and gas MNEs have reinvigorated their expansion in developing countries.[86]

1.4.3 South, East, and South-East Asia Regional Primary Sector Purchases Increase: *Indian and Chinese* FDI Outflows to Natural Resources are Increasing

Between 2005 and 2010, South, East, and South-East Asian cross-border M&A purchases in the primary sector; mining quarrying and petroleum; progressed from $4.5 billion in 2005,[87] to $7.3 billion in 2006,[88] to $2.3 billion in 2007,[89] to $8.1 billion in 2008,[90] to $13 billion in 2009,[91] to $23.9 billion in 2010.[92] Moreover, in 2005, 8.9% of the regions overall M&A purchases were in the primary sector. In 2010, 25% of the regions overall M&A net purchases were in the primary sector.

The number and value of M&A and greenfield extractive industry projects undertaken in 2010 are up by nearly 350% over those undertaken in 2005. The region's outward FDI in oil, gas, metals, and mining, accounts for a significant and growing proportion of the total FDI from the region, led by outward FDI from China and India.[93] Chinese MNE activity in outward FDI directed towards the extractive sector has accounted for more than 20% of total FDI outflows per year over the last few years.[94] Indian MNE international natural resource sector activity between 2005 and 2006 reveal that 22% of total outward FDI was in the energy and metals

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[83] Ibid. p. 4.
[84] UNCTAD 2011, see note 2 at Chapter II, Regional Investment Trends, Box II.3 p. 67.
[85] Kuznetsov, A., see note 82 at p. 8.
[86] Ibid.
[87] UNCTAD 2008, see note 16 at p. 51.
[88] Ibid.
[89] UNCTAD 2009, see note 76 at Regional Trends, South, East and South-East Asia: value of cross-border M&A sales and purchases, by sector/industry, 2007-2009, Figure II.10 p. 54.
[90] UNCTAD 2010, see note 26 at Regional Trends in FDI, b. Asia, South, East, and South-East Asia, (1) Recent Trends, Table D. Cross-border M&As by industry, 2008-2009 p. 38.
[91] UNCTAD 2011, see note 2 at Chapter II Regional Investment Trends, 2. South, East and South-East Asia, Table D. Cross-border M&As 2009-2010 p. 45.
[92] Ibid.
[93] UNCTAD 2011, see note 2 at p. 47.
[94] UNCTAD 2011, see note 2 at pp. 47-48.

sectors.[95]

1.5 Conclusion: Recent Outward FDI Trends

The recent rise of global FDI outflows has been interrupted by the financial and economic crisis. By contrast, outward FDI data from the last six years, show that the natural resource sectors have attracted increasing amounts of international investment globally. In addition, although outward FDI globally has fallen off, outward FDI from emerging economies, such as the BRICs, has remained in an upward trajectory. An emblematic and important segment of this FDI shift, between developed and developing countries is the increasing outward FDI to the natural resource sectors from emerging economies. The magnitude of this shift and the developing trend is truly remarkable and signifies a complex and multivariate new phenomenon.

2. The Prominence Of Global Public Investors

Chapter two adds an additional layer to the analysis done in the first chapter. The recent increases in outward FDI to the natural resource sectors from emerging economies is undertaken by GPIs and therefore, embodies a different dynamic than outward FDI by private MNEs. The dynamic is direct government control and government influence.

Unlike country specific FDI outflow statistics and regional cross-border M&A purchase data, measuring the increase in *government controlled* FDI outflows, especially from developing and transition countries, requires a descriptive approach.[96] Comprehensive time-series data to measure the amount of FDI outflows deployed by emerging economy SOEs and SWFs does not exist.[97] Nonetheless, GPIs from developing and transition economies are becoming increasingly influential on the international investment landscape. Therefore, a probing descriptive examination is well warranted.[98]

2.1 The Significance of SOEs and SWFs Globally

SOEs and SWFs together control assets worth trillions of dollars.[99] Projections for the next

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[95] Taylor, H., Nolke, A. 'Global Players from India: A Political Economy Perspective', in Sauvant, K. Maschek, W. McAllister, G. (eds.), *Foreign Direct Investment from Emerging Markets: The Challenges Ahead*, New York, NY: Palgrave MacMillan, 2010, p. 151.

[96] As a note, broader economic indicative metrics do exist, such as, the Heritage Economic Freedom Index, the World Bank IFC Doing Business Index, and the World Bank's Privatization database. However, these measures fail to capture the level of government controlled FDI, especially government controlled FDI in the natural resources sectors.

[97] Comprehensive SOE statistics do not exist, UNCTAD, 'Non-Equity Modes of International Production and Development', *World Investment Report*, 2011, p. 32. Comprehensive SWF statistics do not exist, West, D. Kimball, R. Nathoo, R. Zwirn, D. Ramachandran, V. Goldstein, G. Moser, J. 'Rebuilding America: The Role of Foreign Capital and Global Public Investors', *Governance Studies at Brookings*, March 11, 2011, p 7.

[98] UNCTAD, 'Non-Equity Modes of International Production and Development', *World Investment Report*, 2011, p. 32. and, West, D. Kimball, R. Nathoo, R. Zwirn, D. Ramachandran, V. Goldstein, G. Moser, J. 'Rebuilding America: The Role of Foreign Capital and Global Public Investors', *Governance Studies at Brookings*, March 11, 2011, p 6.

[99] West, D. Kimball, R. Nathoo, R. Zwirn, D. Ramachandran, V. Goldstein, G. Moser, J. 'Rebuilding America: The Role of Foreign Capital and Global Public Investors', *Governance Studies at Brookings*, March 11, 2011, p 1.

decade suggest that GPI investments will grow sizably and the global prominence of GPI investments will continue to increase.[100] Therefore, in the ongoing and erratic, financial and economic environment, GPI investments will have an outsized impact on economic development around the world.[101]

There are approximately 650 SOEs operating internationally with more than 8,500 foreign affiliates. In addition, there are roughly 80 SWFs globally.[102] SOEs control no less than $1.2 trillion of global outward FDI stock, and controlled $146 billion of global FDI outflows in 2010.[103] In addition, SWFs had $4.7 trillion dollars of assets under management as of October 2011.[104] Combined SOEs and SWFs control almost $6 trillion dollars. (By way of contrast, the total value of all hedge fund assets under management globally, reached a record amount of $2 trillion in 2010.)[105]

SOEs and SWFs are undoubtedly key actors in today's international investment regime, but GPIs are not new.[106] However, their international expansion characterized by increasing outward FDI is a recent and rising phenomenon.[107] Illustratively, the number of foreign GPI affiliates is a recent phenomenon that has not previously been measured. New firm-level data and analysis suggest an increase in the number of SOEs globally when accounting for the increasing number of their affiliates.[108] In addition, no less than 19 new SWFs have been established since 2005, 2 so far in 2011.[109]

2.2 The Global Prominence of SOEs

Increasingly, SOEs include international operations. SOEs include home country-based parent companies and foreign-based affiliates. SOEs are legally incorporated commercial businesses whose ownership is influenced to a meaningful extent by the home government.[110]

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[100] Ibid.
[101] Ibid.
[102] UNCTAD 2011, see note 2 at p. 28.
[103] UNCTAD, 'Non-Equity Modes of International Production and Development', *World Investment Report*, 2011, p. 32. and, UNCTAD, 'Non-Equity Modes of International Production and Development, Annex table I.1 and tableI.5 ', *World Investment Report*, New York and Geneva: 2011, pp. 187-203.
[104] Sovereign Wealth Fund Institute 'Sovereign Wealth Fund Rankings', *www.swfinstitute.org*, October, 2011, available at, <http://www.swfinstitute.org/fund-rankings/>
[105] Jones, S., McCrum, D. 'Hedge funds surge to peak of $2,002bn', London and New York: *Financial Times, www.ft.com*, April 19 2011, available at, <http://www.ft.com/intl/cms/s/0/56c3e1da-6aaa-11e0-80a1-00144feab49a.html#axzz1bRCjfeQK>
[106] Miroudot, S. Ragoussis, A. 'New Actors in the International Investment Scenario: Objectives, Performance and Advantages of Affiliates of State-Owned Enterprises and Sovereign Wealth Funds', *Paper prepared for the, World Trade Forum New Directions and Emerging Challenges in International Investment Law and Policy*, Bern, Switzerland: World Trade Institute, Berne, 9-10 September 2011, p 3-4.
[107] Ibid. p. 2.
[108] Miroudot, S. Ragoussis, A, see note 106 at p. 2.
[109] Sovereign Wealth Fund Institute, 'Current Trends-Sovereign Wealth Funds', *www.swfinstitute.org*, October, 2011, available at, <http://www.swfinstitute.org/what-is-a-swf/>
[110] See in its entirety, Musacchio, A. and Flores-Macias, F. 'The Return of State-Owned Enterprises,' *Harvard International Review*, 2009. available at, <http://hir.harvard.edu/the-return-of-state-owned-enterprises?page=0,0>

Meaningful extent includes, full, majority, ownership, or influential, controlling stake. Control is the umbrella term that describes various degrees of government influence. Influential control is difficult to quantify and may be more descriptively appropriate. It does include, government as the largest minority shareholder, or "golden shareholder".[111] Definitions of what constitute an ownership stake also differ. An ownership stake is commonly defined as a stake of 10% or more of the firm's voting power. Ownership is evident in many forms, including, government control over an SOEs supervisors, and government control over an SOE's funding.[112] Majority control is defined by a greater than 51% stake. Full control is defined as a 100% stake. In addition, "state-owned" refers to both national and sub-national governments, although sub-national SOEs are less likely to internationalize.[113]

The distinguishing characteristic of SOE investments is the link between government control and government influence. That is to say, the level of government influence, and not the absolute level of government ownership, defines an SOE. To be sure, the level of government ownership is often a good proxy for the level of government influence over a particular firm, however, an SOE in which the government possesses a "golden share" among stakeholders can be equally as influential over an SOE as one in which the government owns a 10%, 51%, or 100% stake.

The percentage of government ownership in all SOEs globally breaks down as follows; 10% of SOEs have less than 10% government ownership, 32% of SOEs have 10-50% government ownership, 44% of SOEs have 51-99% government ownership, and 14% of SOEs have a 100% government ownership stake.[114]

SOEs have started to globalize in a myriad of ways. SOEs may engage in international cross-border M&A, establish greenfield investments abroad, or create foreign affiliates.[115] A breakdown of all combined SOE cross-border M&As purchases and greenfield projects globally, between 2005 and 2010, reveals that in 2005 they totaled roughly $105 billion, and in 2010 the totaled, roughly $145 billion.[116] In 2005 they accounted for roughly 7% of total FDI. In 2010 no less than 11% of total global FDI flows were attributed to SOEs,[117] and 6% of the total global FDI stock is controlled by SOEs.[118]

2.2.1 The Prominence of SOE Outward FDI from Emerging Economies

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[111] UNCTAD 2011, see note 2 at p. 28.
[112] OECD, 'State owned enterprises in China: reviewing the evidence,' OECD, *Occasional Paper, Working Group on Privatization and Corporate Governance of State Owned Assets*, 26 January 2009, pp. 1-15.
[113] UNCTAD 2011, see note 2 at p. 28.
[114] UNCTAD 2011, see note 2 at p. 29.
[115] Miroudot, S. Ragoussis, A., see note 106 at p. 2.
[116] UNCTAD 2011, see note 2 at p. 33.
[117] UNCTAD 2011, see note 2 at p. xiii.
[118] UNCTAD 2011, see note 2 at p. 32.

The past 10 years have revealed the emergence, or reemergence, of prominent international investments by emerging economy MNEs in which governments are very influential.[119] Emerging economy SOEs are increasingly internationalizing their operations.[120] SOEs from developing and transition economies are more likely to be majority government controlled than SOEs from developed economies.[121]

Despite the high concentration of SOEs in Europe, 56% of all SOEs worldwide are from developing and transition economies.[122] UNCTAD lists the number of SOEs from key emerging economies and their corresponding share of the global total.[123] While the total number of SOEs from each country is less certain, their global percentage share is representative. Brazil is home to 1.4% all SOEs globally; Russia, 2.1%; India, 3.1%; China, 7.7%; South Africa, 8.3%; Malaysia, 6.9%; Kuwait, 2.9%; and the United Arab Emirates, 3.2%. These are the leading emerging SOE source economies.[124]

In Brazil, substantial government influence over MNEs is particularly noticeable in the natural resources sector.[125] Petrobras is a parastatal SOE oil company that the Brazilian government has recently bestowed with sole operator status of new oil discoveries.[126] The government's recent intervention from its "golden share" vote in mineral giant Vale is another good example.[127]

The Russian government's support for MNE internationalization has been integral and increasing since 1999.[128] The Russian government has always influenced the behavior of its MNEs and their FDI activity,[129] but Russian SOE activity and FDI outflow investment is now significant on the international level.[130] Outward FDI, cross-border M&A purchases, and greenfield investments by Russian SOEs rose between 2009 and 2010 due to favorable support

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[119] UNCTAD, 'Non-Equity Modes of International Production and Development', *World Investment Report*, 2011, p. 32. and, Dunning, J. and Lundan, S. *Multinational Enterprises and the Global Economy*, Cheltenham, UK: Edward Elgar Publishing Limited, 2008, (2nd edn.), p. 62.

[120] Musacchio, A., Flores-Macias, F., see note 110 in its entirety.

[121] UNCTAD 2011, see note 2 at pp. 29-30.

[122] UNCTAD 2011, see note 2 at p. 29.

[123] UNCTAD 2011, see note 2 at p. 31.

[124] UNCTAD 2011, see note 2 at pp. 29-31.

[125] USCS, Doing Business in Brazil: 2011 Country Commercial Guide for U.S. Companies, 'Chapter 6: Investment Climate, Competition from state-owned enterprises' *U.S. & Foreign Commercial Service And U.S. Department Of State*, 2011p. 71.

[126] Ibid.

[127] Parish Flannery, N. 'Brazilian Government Pushes out Mining Giant Vale's Popular CEO, Raising Investor's Concerns' *Forbes, www.blogs.forbes.com* April 22, 2011. available at, <http://foundersforum.gmiratings.com/2011/04/brazilian-government-pushes-out-mining-giant-vales-popular-ceo-raising-investors-concerns.html>

[128] Sauvant, K. Maschek, W. McAllister, G., see note 31 at p. 11.

[129] Kalotay, K. 'Takeoff and Turbulance in the Foreign Expansion of Russian Multinational Enterprises', in Sauvant, K. Maschek, W. McAllister, G. (eds.), *Foreign Direct Investment from Emerging Markets: The Challenges Ahead*, New York: New York, Palgrave MacMillan, 2010, p. 127.

[130] Sauvant, K. Maschek, W. McAllister, G., see note 31 at p. 11.

by the government.[131] They can be both effective semi-market-oriented MNEs and "clumsy giants"[132] that cannot internationalize or even survive without full government support.[133] SOEs have a 26% share of the total foreign assets owned by Russian MNEs.[134]

India is another country with a large number of SOEs.[135] Despite privatization efforts, stretching back to the early 1990s, the overall level of Indian SOEs has remained steady while their role in India's internationalization strategy has risen over the last decade.[136] International Indian SOEs have held up well during the financial and economic crisis.[137]

State-owned MNEs from China are often firmly controlled by the State, through majority or full-government ownership stakes. Indeed, China's outward FDI involves high levels of SOE involvement.[138] Chinese SOEs actively started internationalizing when the, “going-global" strategy was adopted in 2000. The strategy sets out government supports and encourages globalization of Chinese SOEs.[139] Today, Chinese SOEs account for 80%–90% of the country’s FDI outflows.[140] Between 2008 and 2009 Chinese SOEs controlled 70% of total Chinese foreign stock.[141]

Specifically, 28 of the largest 100 MNEs from developing and transition economies are SOEs.[142] Between 1980 and 2010, the number of SOE cross-border M&A purchases *globally*, reveals the relative significance of developed economy SOEs between 1980 and 1990, and the subsequent relative significance of developing and transition economy SOEs between 2000 through 2010. Recently, the surging SOE FDI outflows have originated in emerging economies.[143]

Between 2003 and 2010, SOEs from emerging economies invested $458 billion dollars towards outward FDI in M&A and greenfield projects to partner emerging economies. This represents roughly two-thirds of all the FDI projects between emerging economies over this time period.[144] In addition, between 2003 and 2010, SOE outward FDI activity accounted for one-

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[131] UNCTAD 2011, see note 2 at p. 64.
[132] Kuznetsov, A., see note 82 at p. 4.
[133] Ibid.
[134] Sauvant, K. Maschek, W. McAllister, G., see note 31 at p. 11.
[135] Musacchio, A. and Flores-Macias, F., see note 110 in its entirety.
[136] OECD, see note 112 at pp. 1-15
[137] Ibid.
[138] Sauvant, K. Maschek, W. McAllister, G. see note 31 at p. 11.
[139] OECD, see note 112 at pp. 1-15.
[140] Cheng, L. Ma, Z. 'China's Outward FDI: Past and Future', *National Bureau of Economic Research Conference* Pre-Conference on China’s Growing Role in the World Trade” held at the National Bureau of Economic Research, Cambridge, Mass., on October 14, 2006.
[141] Hurst, L. 'Comparative Analysis of the Determinants of China's State-owned Outward Direct Investment in OECD and Non-OECD Countries', *China & World Economy*, Vol 19, No. 4, 2011, p. 75.
[142] UNCTAD 2011, see note 2 at p. 28.
[143] UNCTAD 2011, see note 2 at p. 32.
[144] Ibid.

third of the *total* outflows from developing and transition economies.[145] Between 2003 and 2010 the sum of all developing economy outflows totaled $1.7 trillion dollars. If transition economies are added to this total, the sum becomes $2 trillion.[146] No less than $544 billion dollars in outward FDI flows were from developing economy SOEs between 2003 and 2010. This amount is more than the total FDI outflows by developing economies in any single year during that period. Given the strong and disproportionate push by key developing and transition economies over the last 6 years, the fact that one-third of that FDI was from SOEs is remarkable.

2.3 The Global Prominence Of SWFs

SWFs have existed for almost 60 years. The Kuwait Investment Authority was established in 1953. But SWFs have grown in prominence recently. Globally, SWFs managed, $3.2 trillion in 2007, $4.1 trillion in 2008, $4 trillion in 2009, $4.1 trillion in 2010,[147] and had $4.7 trillion of assets under management as of October 2011.[148] The top 10 SWFs now account for roughly 85% of total SWF assets, or $3.5 trillion.[149]

SWFs are vehicles designed to invest excess national, state-owned, money. These excesses are primarily generated in two ways: (1) From the profitable sale, or taxation, of nationally owned natural resources, usually from oil resources.[150] (2) From other forms of excess foreign exchange reserves, such as those generated by trade surpluses.[151]

SWF investments consist of both foreign portfolio and foreign direct investment. The difference between portfolio and direct investment is not always easily discernable.[152] To the extent that SWF investment captures a 10% ownership interest in foreign assets, SWF investment is considered, and represented by, FDI statistics. Between 2005 and 2007, 25% of SWF investment was direct investment and along with a 10% stake in the acquired company, the nature of SWF direct investment also includes a long-term relationship with the company and an involvement in the company's management.[153] SWF FDI has been increasing recently.[154]

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[145] Ibid.
[146] UNCTAD 2011, see note 1 at Annex table I.1pp. 187-190, and UNCTADstat.org.
[147] West, D. et al., see note 99 at p. 7.
[148] Sovereign Wealth Fund Institute 'Sovereign Wealth Fund Rankings', www.swfinstitute.org, October, 2011, available at, <http://www.swfinstitute.org/fund-rankings/>
[149] West, D. et al., see note 99 at p. 7.
[150] West, D. et al., see note 99 at pp. 6-7.
[151] W. Lu K., Verheyen, G., Perera, S. *Investing With Confidence: understanding political risk management in the 21st century*, MIGA The World Bank Group, 2009. pp. 65-67.
[152] Park, D. and Estrada, G, 'Developing Asia's Sovereign Wealth Funds and Outward Foreign Direct Investment', *Asia Development Review,* Asia Development Bank, vol. 26 no. 2. 2009, pp. 57-85.
[153] W. Lu K., Verheyen, G., Perera, S. *Investing With Confidence: understanding political risk management in the 21st century*, MIGA The World Bank Group, 2009. pp. 65-67. and Park, D. and Estrada, G, 'Developing Asia's Sovereign Wealth Funds and Outward Foreign Direct Investment', *Asia Development Review,* Asia Development Bank, vol. 26 no. 2. 2009, pp. 57-85.
[154] W. Lu K., Verheyen, G., Perera, S., see note 151 at pp. 65-67

SWFs have grown significantly since the early 2000s.[155] Between 2000 and 2005 outward FDI by SWFs totaled less than $2 billion dollars annually. In 2005 the amount of annual FDI from SWFs was roughly $8 billion, in 2006 roughly $11 billion, in 2007 roughly $17 billion, in 2008 roughly $19 billion and in 2009 the total amount of FDI by SWFs was roughly $22 billion.[156] In addition, SWF investment in cross-border M&A totaled less than 0.5% in 2004 and increased to 2.5% in 2009.[157] Moreover, the IMF projects that the total value of all the assets under management controlled by SWFs could reach $12 trillion dollars by 2015.[158] The recent growth of SWFs is emblematic of a bigger trend. That is, of government controlled, global wealth, economic power, and FDI outflows.[159]

2.3.1 The Prominence Of SWF Outward FDI From Emerging Economies

The amount of assets under management controlled by key emerging economy SWFs has been growing quickly in recent years. The industry's concentration of assets under management now resides overwhelmingly in emerging economy SWFs. Six main developing and transition countries from three distinct regions control the biggest SWFs in the world. They are; Saudi Arabia, the United Arab Emirates, and Kuwait, all GCC member states from West Asia; China and Singapore in East Asia; and Russia in the CIS.[160]

Select East Asian countries and the GCCs are the primary home countries of SWF investment vehicles. The GCC SWFs together account for $1.6 trillion dollars of assets under management, this is roughly 36% of all SWF assets globally.[161] The United Arab Emirates is home to the worlds largest SWF, the Abu Dhabi Investment Authority with $627 billion dollars The United Arab Emirates controls 6 other SWFs, with cumulative assets under management of more than $719 billion dollars. Saudi Arabia is home to the worlds fourth largest SWF, and when combined, the country's 2 SWFs have $478 billion dollars under management. Kuwait is home to the sixth largest SWF with $296 billion dollars. Qatar is home to the twelfth largest SWF, with $85 billion dollars under management. Bahrain has one SWF, totaling $9 billion dollars. The GCC country SWFs account 35%, or $1.6 trillion dollars of total SWF assets under

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[155] Monitor, Barbary, V. Bortolottic, B. (eds.) 'Braving the New World: Sovereign Wealth Fund Investment in the Uncertain Times of 2010', *Monitor Company Group L.P.* June 2011, pp. 6-7. <http://www.monitor.com/Portals/0/MonitorContent/imported/MonitorUnitedStates/Articles/PDFs/BTNW_Final.pdf>

[156] UNCTAD 2010, see note 26 at p. 14.

[157] Miroudot, S. Ragoussis, A., see note 106 at p. 2.

[158] The Economic Times, October 8, 2011. available at, <http://articles.economictimes.indiatimes.com/2011-10-08/news/30258125_1_stabilisation-fund-assets-imf/2>

[159] Truman M. Edwin, "Sovereign Wealth Funds and the Global Economy: Theater or Salvation?" PIIE, September, 2010.

[160] West, D. et al, see note 99 at p. 8.

[161] Sovereign Wealth Fund Institute 'Sovereign Wealth Fund Rankings', www.swfinstitute.org, October, 2011, available at, <http://www.swfinstitute.org/fund-rankings/>

management. There are currently 3 Chinese SWFs and together there are 9 Asian SWFs that account for 40% of total SWF assets under management.[162]

Notably, Brazil and Russia are also now both homes to one SWF apiece. Brazil's, $11 billion dollar, Sovereign Fund of Brazil, and Russia's, $142 billion dollar National Welfare Fund (which includes the oil stabilization- fund of Russia), were both established in 2008.[163] India is another country mulling over the idea of establishing a SWF. The idea is for a $10 billion dollar fund to help finance the acquisition of foreign energy assets to fuel India's increasing needs.[164]

2.4 Global FDI Outflows to the Natural Resources Sectors by GPIs are Increasing

SOEs and SWFs are different in some ways. Government control is perhaps more direct in SOEs than in SWFs. SOE investment objectives, although highly obfuscated, are perhaps more clear than SWF investment strategies. However, SOEs and SWFs both operate under an extent of government control, both engage in various levels of direct investment, and both reflect investment motives that emanate from the business, economic, *and* political environments of home and host countries.[165]

GPIs now play a substantial role in the global economy,[166] and natural resource sector FDI exhibits a more pervasive history of direct home-country government support than any other sector.[167] UNCTAD estimates that 8.6% of total SOE activity, in all sectors globally, is in the primary sector. Within the primary sector, 7.4% is in mining, quarrying and petroleum. In addition, 3.1% of SOEs operate in metals and metal product manufacturing.[168] SWFs too, are focusing more of their investments on the natural resource sectors recently, especially in 2010.[169]

The financial and economic crisis is having an impact on SWFs. Between 2007 and 2008 20% of FDI by SWFs was allocated towards the primary sector; mining, quarrying and petroleum. The primary sector was the second most targeted sector behind financial services. Between January of 2009 and May of 2010 SWF investment in the primary sector increased and

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[162] Ibid.
[163] Ibid.
[164] The Economic Times. October 8, 2011. available at, <http://articles.economictimes.indiatimes.com/2011-10-08/news/30258125_1_stabilisation-fund-assets-imf/2>
[165] See generally, West, D. Kimball, R. Nathoo, R. Zwirn, D. Ramachandran, V. Goldstein, G. Moser, J. 'Rebuilding America: The Role of Foreign Capital and Global Public Investors', *Governance Studies at Brookings*, March 11, 2011.
[166] UNCTAD 2011, see note 2 at p. xiii.
[167] Moran, T. *Foreign Direct Investment and Development: Launching a Second Generation of policy research: Avoiding mistakes of the first, reevaluating policies for developed and developing countries*, Peterson Institute for International Economics, Washington DC: 2011, p. 18.
[168] UNCTAD 2011, see note 2 at p. 31.
[169] Monitor, Barbary, V. Bortolottic, B. (eds.) 'Braving the New World: Sovereign Wealth Fund Investment in the Uncertain Times of 2010', *Monitor Company Group L.P.* June 2011. pp. 6-7. available at, <http://www.monitor.com/Portals/0/MonitorContent/imported/MonitorUnitedStates/Articles/PDFs/BTNW_Final.pdf>

accounted for 26% of SWF asset allocation.[170] In 2010, SWFs invested heavily in the natural resource sectors; coal, petroleum, natural gas, and metals.[171]

To be sure, trends are emerging quickly and evolving rapidly. As recently as 2007, UNCTAD suggested that, with the exception of the oil and gas industry, and with the exception of China, the privatization process worldwide in the natural resource sectors, particularly in the metal mining industry, was "more or less" complete.[172] However, over the last five years it appears more likely that "resource nationalism" in all natural resource sectors is actually on the rise.[173] Resource nationalism does not automatically lead to increasing outward FDI to the natural resource sectors by GPIs. However, it does lead to more state control over domestic resources, and a higher degree of SOE participation in natural resource production.[174]

2.4.1 Emerging Economy Outward FDI by GPIs To Natural Resources is Increasing

GPIs from developing and transition economies operating in the natural resources sector have recently evolved into leaders, competing globally for, oil, gas, metal, and mineral resources.[175] Natural resource FDI by GPIs is more likely to originate from developing and transition economies than from developed economies.[176] More specifically, the majority of natural resources-based outward FDI from the BRIC economies comes from SOEs.[177]

The influence of emerging economy GPIs engaged in natural resources FDI is increasing.[178] In developing and transition economies, influential GPIs have emerged in the natural resources sectors such as, oil, gas, minerals, and metals.[179] Notable examples include; Brazilian, CVRD and Petrobras; Russian, Gazprom and Lukoil; Indian, ONGC Videsh and Indian Oil Corporation; Chinese, Bao steel, CNPC, Sinopec, and CNOOC; Saudi Arabian, Saudi Aramco; South African, Sasol; Malaysian, Petronas; Thai, PTTEP; Chilean, ENAP; Venezuelan,

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[170] UNCTAD 2010, see note 26 at p. 14.

[171] Monitor, Barbary, V. Bortolottic, B. (eds.) 'Braving the New World: Sovereign Wealth Fund Investment in the Uncertain Times of 2010', *Monitor Company Group L.P.* June 2011. pp. 6-7. available at, <http://www.monitor.com/Portals/0/MonitorContent/imported/MonitorUnitedStates/Articles/PDFs/BTNW_Final.pdf>

[172] UNCTAD 2007, see note 17 at p. 108.

[173] Reuters, Staff, 'Resource Nationalism is Biggest Risk to Miners', *www.reuters.com*, London: August 7 2011, available at, <http://www.reuters.com/article/2011/08/07/us-mining-risks-report-idUSTRE7761AU20110807>

[174] Blas, J. 'Resource Nationalism Returns to Commodities', Financial Times London: *www.ft.com*, June 14, 2011, available at, <http://www.ft.com/intl/cms/s/0/2b1fa352-9651-11e0-afc5-00144feab49a.html#axzz1bAm0dCNi>

[175] West, D. et al., see note 99 at p. 6.

[176] UNCTAD 2011, see note 2 at table I.27 p. 33.

[177] VanTulder, R., 'Toward a Renewed Stages Theory for BRIC Multinational Enterprises? A Home Country Bargaining Approach' in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, Palgrave Macmillan, 2010, pp. 64-65.

[178] John Dunning does not write about GPIs. He writes of government owned MNEs. I have used his observations to extend to both SOEs and SWFs as the two most prominent GPIs. Dunning, J. and Lundan, S. *Multinational Enterprises and the Global Economy*, Cheltenham, UK: Edward Elgar Publishing Limited, second edition, 2008, p. 62.

[179] UNCTAD, 'FDI from Developing and Transition Economies: Implications for Development', New York and Geneva: *World Investment Report, 2006,* p. xxv.

Petroleos (PDVSA); Iranian, National Iranian Oil Company; and Korean, Posco.[180]

Between 2003 and 2010 roughly 40% of all SOE FDI projects from developing and transition economies were in the natural resources sector.[181] Over the longer-term, between 1981 and 2010 roughly 37% of all SOE FDI projects from developing and transition economies were in natural resources.[182] This indicates that SOE FDI in natural resources has been larger over the last eight years than the previous twenty-two years.

In 2003 and 2004 fifteen of the top twenty-five oil and gas companies, ranked by reserves and production, were SOEs from developing and transition economies and three more had minority state ownership.[183]

Until recently the largest oil MNEs were all privately owned corporations from developed economies, but over the last 10 years things have changed. As of 2005, the largest oil and gas companies, ranked by total reserves, were all SOEs from developing and transition economies, which are rapidly internationalizing.[184] The prevalence of GPI behavior and FDI activity in the natural resource sectors is perhaps most common in the oil and gas industry, where the largest companies globally are state-owned.[185]

In 2005 the world's three biggest oil and gas MNEs, by production and reserves, were all SOEs based in developing and transition economies. In addition, over 50% of the top fifty oil and gas MNEs were majority state-owned. The breakdown—twenty-three from developing countries, twelve from South-East Europe and the CIS, and fifteen from developed countries.[186]

In 2007 the *Financial Times* named the new "seven sisters" in the oil and gas industry, and all are SOEs. They are, Aramco of Saudi Arabia, Gazprom of Russia, CNPC of China, NIOC of Iran, PDVSA of Venezuela, Petrobras of Brazil, and Petronas of Malaysia. These seven SOEs control roughly 30% of all oil and gas, production and reserves, globally. [187] Between 2008 and 2010 natural resources-based GPIs have taken advantage of the financial and economic crisis to increase their outward FDI activities.[188] In 2010, SOEs from emerging economies continued to allocate FDI towards acquisitions in, oil, gas, minerals and metals.[189] Notable examples include, the $7 billion purchase by China's Sinopec Group of Brazil's Repsol, and the $4.8 billion

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[180] UNCTAD, 'FDI from Developing and Transition Economies: Implications for Development', *World Investment Report, 2006*, p. xxv. and UNCTAD, 'Transnational Corporations, Extractive Industries and Development', *World Investment Report,* 2007, pp. xxii-xxiii.
[181] UNCTAD 2011, see note 2 at figure I.27 p. 33.
[182] UNCTAD 2011, see note 2 at figure I.29 p. 34.
[183] UNCTAD 2007, see note 17 at pp. 116-121.
[184] UNCTAD 2007, see note 17 at pp. 115-119.
[185] UNCTAD 2007, see note 17 at figures, IV 9, IV 10, IV 11, pp. 116-122.
[186] UNCTAD 2007, see note 17 at pp. xxii-xxiii.
[187] Dunning, J. and Lundan, S., 2008 see note 14 at pp. 29-30.
[188] Kuznetsov, A., see note 82 at p. 8.
[189] UNCTAD 2011, see note 2 at p. 10.

purchase by India's ONGC subsidiary OVL, of Carabobo Venezuala.[190]

Throughout the current financial and economic crisis SWFs from emerging economies have increasingly allocated significant investments into commodities, especially in mining.[191] After the recent depths of the financial and economic crisis, China's CIC directed investments into industries that it considered of long-term strategic value to China's economy—the mining and minerals industries.[192] In 2009 and 2010 Asian SWFs invested heavily in Latin American natural resources assets.[193] In 2011 the Saudi Arabian Monetary Agency's SWF arm, with roughly $431 billion dollars of assets under management,[194] is focusing on mineral resources investments.[195]

2.5 Conclusion: The Prominence Of Global Public Investors

GPI's are a significant source of outward FDI that is directed around the world to the natural resource sectors. More specifically, the prominence of SOEs and SWFs originates from key developing and transition economies that display rising appetites for natural resources. Therefore, emerging economy GPIs are increasingly engaged in outward natural resource sector FDI. Government controlled MNEs are different than private MNEs, and yet the government dynamic is less well understood. Because they are government controlled, and they originate from developing and transition economies, and they focus meaningful amounts of investment on the natural resource sectors, their increasing prominence is important to understand.

3. GPI Political Ownership Advantages Determine the Firm-Level Causes of Outward FDI

3.1 Introduction

Chapter 3 sets out to establish the firm-level causes of GPI natural resource sector FDI. The analysis will focus on the relationship between the control a home government wields over GPI behavior, and a GPI's outward FDI activity. Unpacking the analysis will unveil an overlooked cause of the contemporary expansion of the FDI phenomenon described in Chapters 1 and 2.

This chapter argues that GPIs possess unique political ownership advantages that derive from government control. These advantages are referred to here as, GPI-specific political ownership advantages.

The *extent* and *nature* of government control over a GPI, provides GPI-specific political ownership advantages that determine the success of GPI outward FDI in the natural resource

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[190] UNCTAD 2011, see note 2 at p. 10.

[191] The Financial Times.www.ft.com available at, <http://www.ft.com/intl/cms/s/0/e5e4f274-6ef5-11e0-a13b-00144feabdc0.html#axzz1ZrsJ80E1>

[192] West, D. et al, see note 99 at p. 13.

[193] Sovereign Wealth Fund Institute. www.swfinstitute.org available at, <http://www.swfinstitute.org/swf-news/korea-swf-and-other-investors-plan-to-invest-in-brazilian-mining/>

[194] West, D. et al, see note 99 at p. 9.

[195] www.cnbc.com. Video interview of the Saudi Arabian Finance Minister discussing, at minute 2:30, the state's SWF investments is available at, http://video.cnbc.com/gallery/?video=3000051174

sectors. In addition, it is necessary for a GPI to internalize market transactions via foreign acquisitions in order to realize their political ownership advantages.

3.1.1 What are Political-Ownership Advantages?

GPI-specific political ownership advantages are the proprietary political assets unique to the government of a specific country that help cause a GPI's outward FDI to succeed. Dunning's Eclectic Paradigm envelopes different strands of international business and economic analysis that describe the various ownership advantages that enable *private* firms to engage in successful outward FDI. Ownership advantages are a "kind of unique and sustainable competitive advantage (or set of advantages), relative to that (or those) possessed by their foreign competitors."[196] In addition, private MNE outward FDI is determined by the ability and desire of a firm to exploit competitive ownership advantages internationally, by internalizing (or owning within the firm), international market transactions that would otherwise be bought and sold independently.[197]

Political ownership advantages are distinct from the Eclectic Paradigm's competitive advantages, in that they derive from unique government assets and not market-oriented competitive assets. Moreover, the advantages reaped by political ownership assets are not measured by market-oriented economic success. GPIs measure success in political terms, and this alternative measure of success is a key component of government control and political ownership advantages.

The argument follows from a critical distinction between the advantages that governments provide to MNEs and the advantages that GPIs receive as a *direct* result of government ownership. To be sure, many MNEs benefit from government support of all kinds, but government ownership provides unique advantages to GPIs that dictate the success of outward FDI. This will be discussed in detail.

3.1.2 What is Political Success?

Political success is the success of GPI outward FDI as measured by the stakeholders—government. This chapter works from the assumption that because GPIs are increasing their outward FDI to the natural resource sectors, they are experiencing a measure of success. It follows that SOEs and SWFs will only expand their international investments if these investments are successful.

Political successes are non-economic accomplishments achieved by a GPI through outward FDI that satisfy stakeholders. Political success is driven by the political influence within a GPI.

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[196] Dunning, J. H. 'The eclectic paradigm as an envelope for economic and business theories of MNE activity', *International Business Review*, *9*, Pergamon, 2000, p. 168.
[197] Ibid. p. 179.

The measure of success is a decisive element of the proceeding analysis. It will be argued that GPIs measure success differently from private MNEs because of government control and influence.

3.1.3 The Structure of Chapter Three

Chapter 3 will first explain the need for a firm-level analysis of GPI behavior. Second, it will review the most relevant firm-level theory and traditional explanations of MNE behavior and FDI activity. Third, it will proceed with an analysis of what sets GPIs apart from private MNEs, and highlight the distinguishing characteristics of the natural resource sector. Fourth, stylized theoretical tools are deployed to scrutinize the ownership advantages of government controlled GPI behavior and FDI activity. The central contention of this chapter's analysis is constructed by combining extant theoretical tenants alongside complementary notions of GPI behavior and FDI activity. Section 3.5 will analyze the *extent* and *nature* of firm-level government influence on GPI behavior and FDI objectives. By discussing the extent and nature of government influence the broad picture of GPI-specific political ownership advantages becomes clearer. An overview of internalization builds the link between the extent and nature of government influence and the reasons GPIs engage in outward FDI to exploit their political ownership advantages. The last section will discuss in turn, four GPI-specific ownership advantages, before concluding. The four GPI-specific political ownership advantages are: (1) political management advantages, (2) unique access to political information advantages, (3) political leverage advantages, and (4) the advantages of unique access to government financing.

GPI-specific political ownership advantages play an important determinant role in GPI behavior and FDI activity in the natural resource sectors. Admittedly and to be clear, firm-level analysis cannot reveal all of the many causes of this growing trend. In addition, political success is not the only measure of a GPI's success. It is not argued that GPI-specific ownership advantages are the only determinant factors of outward FDI. However, a firm-level analysis proffers impactful insight that is often overlooked.

GPI behavior and FDI activity in the natural resource sectors is intensifying. Therefore, it is natural to ask, 'why', 'what', and 'how' this trend is emerging? Unfortunately, answering 'why' governments are involved in natural resource FDI is often answered hastily. Indeed, analysis often puts the effects before the causes, and the prescriptions before the diagnoses, and lacks any firm-level analysis.

3.2 The Benefits and Necessities of a Theoretical Firm-Level Analysis of GPI Behavior

Available theoretical tools to address outward FDI by GPIs are scarce.[198] This can be

[198] Kraemer, R. and Van Tulder, R. 'Internationalization of TNCs from the extractive industries: a literature review', *UNCTAD, Transnational Corporations*, Vol. 18, No. 1, April 2009, p. 137.

attributed to three likely factors. (1) The common perception that explanations surrounding international natural resource production are decided, leaving nothing left to understand.[199] (2) Firm-level theoretical neglect is because natural resource production is perpetually engulfed in political controversy, which often serves to remove the study of international GPI natural resource investment from the fields of international business, economics, and investment, in favor of a political science perspective.[200] (3) GPIs are government enterprises, but available firm-level theory predominantly addresses private MNEs. Therefore, the roadmap for an analysis is sparse.

Nonetheless, this chapter applies Dunning's Eclectic—international business, industrial organization, and international economic—Paradigm, to the emergence of developing and transition economy GPIs engaged in natural resource sector FDI.[201] The benefit of pursuing a firm-level analysis is the potential for a better understanding of the emerging critical international presence of government led outward FDI. It is necessary to understand GPI outward FDI because protectionism hangs in the balance.

3.2.1 The Confusion Behind Conventional Explanations

Typical explanations deployed to describe government involvement in natural resource production, and the increase in outward FDI towards the natural resource sectors, often cite causes devoid of a theoretical firm-level analysis. Therefore, existing conclusions surrounding this resurgent phenomenon can be incomplete and subtly misleading. Typical explanations are as follows:

(1) Developing and transition country economic growth is expanding rapidly. Therefore, outward FDI directed to the natural resource sectors is increasing to meet demand and fuel economic development. But why do GPIs seek to *own* foreign natural resource assets? That is, why do they choose to internalize international production as opposed to simply buying the assets that are demanded on the open market, in arms-length transactions? And indeed, if internalization does offer a GPI commercial and economic benefits (such as transaction cost benefits), what then explains the increasing importance of government control over natural resource-based MNEs? Economic analysis proposes that government control obstructs efficiency and profitability and increases costs. Arguments that suggest government involvement is necessary to provide the financial scale required, ignore the fact that adequate financial support can be offered independent of government ownership, control, or direct influence.

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[199] Ibid.
[200] Ibid. p. 138.
[201] The Eclectic Paradigm combines disciplines. It can perhaps be called a cross-disciplinary firm-levle approach to understanding MNE behavior and FDI activity. Dunning, J. H., 2000, see note 196 at pp. 168-170.

(2) Natural resources are strategic assets.[202] Therefore, governments control GPI activity in the natural resource sectors. Explanations that mention 'strategic assets' vary as to a precise meaning.[203] In the media, strategic assets often connote strategic national policy objectives aimed at power politics and ulterior motives. Theoretically, strategic assets often refer to those assets that are useful for the development of a firms market position and future profits. It is true that natural resources are strategically important in many ways to the economic *and* political development of home *and* host governments. However, this has always been true. If the cause of GPI outward FDI is the strategic nature of natural resources, what then explains the recent increase in GPI outward FDI in natural resources? Furthermore, there are two sides to every transaction, if governments view natural resources as strategic assets, why then are host governments increasingly amenable to giving up their strategic assets to foreign GPI led FDI in natural resources? Indeed, the recent increase in merger activity and various forms of joint ventures are evidence that government control is not synonymous with strategic capture, and instead displays a high level of cooperation.

(3) Emerging economy governments mistrust private MNEs from developed countries to adequately provide natural resource supplies. Because natural resource supplies are a critical component of national economic development policy, governments seek to control natural resource companies and their value chains abroad.[204] This explanation also jumps to conclusions that disregard the many political and economic forms of cooperation that are necessary to produce and sell natural resources.

(4) Governments seek to collect increasing rents from high commodity prices. By owning natural resource production governments can make money that will help pay for economic development and fiscal deficits. Therefore, governments control natural resource companies.[205] This is likely an important causal element, however, it does not explain how government control organizes natural resource production to ensure increasing profitability. Again, economic

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[202] Kraemer, R. and Van Tulder, R. 'Internationalization of TNCs from the extractive industries: a literature review', *Transnational Corporations*, Vol. 18, No. 1, April 2009, p. 142. Moran, T. *Foreign Direct Investment and Development: Launching a Second Generation of policy research: Avoiding mistakes of the first, reevaluating policies for developed and developing countries*, Peterson Institute for International Economics, Washington DC, 2011, p. 18. and, UNCTAD, 'Non-Equity Modes of International Production and Development, Table I.8', *World Investment Report*, 2011, pp. 32-34. and Hurst, L. 'Comparative Analysis of the Determinants of China's State-owned Outward Direct Investment in OECD and Non-OECD Countries', *China & World Economy*, 74-91, Vol 19, No. 4, 2011, p. 82. and, Dunning, J. and Lundan, S. *Multinational Enterprises and the Global Economy*, Cheltenham, UK: Edward Elgar Publishing Limited, second edition, 2008, pp. 29-30. and OECD, 'State owned enterprises in China: reviewing the evidence,' OECD, *Occasional Paper, Working Group on Privatization and Corporate Governance of State Owned Assets*, 26 January 2009.

[203] Kraemer, R., Van Tulder, R., see note 198 at p. 142.

[204] Dargin, J. 'Resource Nationalism: From Spanish Roots to an Arab Tree', *Harvard Lecture*, June, 6 2011**,** at minute 50, available at < http://www.youtube.com/watch?v=yT1WGTaafCI>

[205] Story by Chris Bishop, on Africa's resurgent resource nationalism, June, 2011, available at, http://www.youtube.com/watch?v=NaqdlSKURPQ

analysis suggests that government control may reduce the level of profitability. Is economic and commercial profit the measure of success that determines emerging economy GPI behavior and FDI activity in the natural resource sectors?

While these explanations broadly cover some common macro-diagnosis and prescriptions, none penetrate the firm-level causes. To be sure, economic growth, commodity price increases, strategic considerations, fiscal deficits, and even foreign policy initiatives, cannot be ruled out and indeed play a role. However, GPI's are not free-market actors and so economic growth and elevated commodity prices alone do not fully explain why GPIs are engaged in outward FDI. In addition, contemplating strategic perceptions leaves plenty to speculative imagination.

Appropriate prescriptions depend on a complete and detailed diagnosis. For example, without a full understanding of the firm-level determinants, actions may take protectionist and exclusionary forms because of the fear that many of the conventional explanations conjure. Firm-level analysis highlights, that although GPIs do not always play the economic game by free-market rules, and politically oriented investment considerations are a reality, cooperation is the cornerstone of their success and is therefore readily accessible.

3.3 GPI Behavior and FDI Natural Resources Activity is Informed by Extant Theory

Traditionally, the majority of FDI flows, both originate from, and are destined for, developed economies. And outward FDI flowed through private MNEs.[206] Discovering the determinant internationalization factors of MNE behavior and FDI allocation has therefore concentrated on the motivations and objectives of private MNEs from developed countries.[207]

Generally, extant FDI theory states: "(1) MNEs internalize missing or imperfect international markets until the costs of further internalization outweigh the benefits. (2) Firms choose foreign locations for their affiliated activities that maximize the benefits and minimize the overall costs of their operations."[208] John Dunning's Eclectic Paradigm fully details and develops the extant theoretical tenants designed to explain private MNE behavior and outward FDI activity.

3.3.1 John H. Dunning's Eclectic Paradigm

Dunning's Eclectic Paradigm is the most inclusive and perhaps most widely accepted framework established to help make sense of private MNE behavior and FDI activity.[209]

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[206] Dunning, J. and Lundan, S., 2008, see note 14 at p. 63.

[207] Globerman, S. and Shapiro, D. 'Outward FDI and the economic performance of emerging markets', in Sauvant, K., and Mendoza, K. and Ince, I. (eds), *The Rise of Transnational Corporations from Emerging Markets: Threat or Opportunity?* Cheltenham, UK: Edward Elgar, 2008, p. 229.

[208] Buckley, P. J., Clegg, J. Cross, A. R., Liu, X., Voss, H., Zheng, P. 'The Determinants of Chinese Outward Foreign Direct Investment', *Center for International Business (CIBUL), Leeds University Business School, University of Leeds*, Westminster Research from the *Journal of International Business Studies*, 38 (4). pp. 499-518, 2007, p. 503.

[209] As a note, Dunning's Eclectic Paradigm is full of reference and reverence to the many titans of firm-level theory, Coase, Penrose, Williamson, Buckley, Casson, Hennart, Aliber, Knickerbocker, Graham, Flowers, Wernerfelt, Conner, Helleloid, Montgomery, Conner, Prahalad, Nelson, Winter, Saviotti, Bartlett, Forsgren, Krugman, Malmberg, and many more.

Dunning seeks to establish a framework within which to analyze the determinants of international production by studying MNE and FDI phenomena and the relationships therein.[210] A variety of theories may coexist within the Eclectic Paradigm to help explain such relationships.[211]

The Eclectic Paradigm is broad-based, and seems to evolve with the research question at issue.[212] It is first based on an analysis of transnational private enterprises and the neoclassical assumption that MNEs are motivated by the private stakeholder's financial interests—profit.[213] Dunning sets out four main types of FDI that motivate MNEs: natural resource seeking, market seeking, efficiency (cost reduction) seeking, and strategic-asset seeking (which is sometimes considered a natural resource seeking subset)[214].[215] The pattern of MNE activity is shaped by the ownership, location, and internalization advantages (OLI variables) of differing MNEs.[216] Analysis of these characteristics allows for, and incorporates, a multitude of economic factors and explanations.[217] Dunning explains his Eclectic Paradigm and the OLI variables succinctly as follows:

> "The paradigm asserts that the extent and pattern of international production, i.e. production financed by FDI and undertaken by MNEs, will be determined by the configuration of three sets of forces: (1) The (net) competitive advantages which firms of one nationality possess over those of another nationality in supplying any particular market or set of markets. These advantages may arise either from the firm's privileged ownership of, or access to, a set of income-generating assets, or from their ability to co-ordinate these assets with other assets across national boundaries in a way that benefits them relative to their competitors, or potential competitors. (2) The extent to which firms perceive it to be in their best interests to internalize the markets for the generation and/or the use of these assets; and by so doing add value to them. (3) The extent to which firms choose to locate these value-adding activities outside their national boundaries."[218]

However, traditional theories and frameworks only go so far to elucidate the determinants of developing country GPI behavior and FDI activity in the natural resources sector.[219] As the

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[210] Dunning, J. and Lundan, S. *Multinational Enterprises and the Global Economy*, Cheltenham, UK: Edward Elgar Publishing Limited, second edition, 2008, p. 78. See also, Dunning's Eclectic Paradigm. Dunning, J. H. 'The Eclectic (OLI) Paradigm of International Production: Past, Present and Future', Int. J. of the *Economics of Business*, Vol. 8, No. 2, 2001, p. 176.
[211] Dunning, J. and Lundan, S., 2008, see note 14 at p. 78.
[212] Dunning, J. and Lundan, S., 2008, see note 14 at p. 80.
[213] Dunning, J. and Lundan, S., 2008, see note 14 at pp. 63-67.
[214] Buckley, P. J., et al, see note 208 at p. 5.
[215] Dunning, J. and Lundan, S., 2008, see note 14 at pp. 67-74.
[216] Dunning, J. and Lundan, S., 2008, see note 14 at pp. 99-100.
[217] Dunning, J. and Lundan, S., 2008, see note 14 at p. 95.
[218] Dunning, J. H. 'The Eclectic (OLI) Paradigm of International Production: Past, Present and Future', Int. J. of the *Economics of Business*, Vol. 8, No. 2, 2001, p. 176.
[219] Globerman and Shapiro share a common view throughout much of the literature asserting the limited scope of traditional theory to explain the behavior of emerging market MNEs, however they do not explicitly relate the theoretical limitations to

previous two chapters have elaborated, the nature of FDI is changing rapidly and in real-time. Shifting FDI trends are unsettling long-engrained global characteristics of FDI. Further exciting the analysis is the increasing participation of public investors from developing and transition countries in the natural resource sectors. Extant theory neither directly addresses the nature of public investors nor the changing landscape of FDI directed towards natural resource sectors.

3.3.2 Theory of Private MNE Behavior and FDI Activity in the Natural Resource Sectors

Theoretically, natural resource seeking FDI is, international investment designed to secure international access and supply of natural resources for commercial purposes.[220] Natural resource FDI is conducted because of the competitive advantages and increased profits available through international operations. Because supplies of raw materials may be expensive or nonexistent in the home country, firms internationalize arms length international market transactions to pursue more profitable and competitive assets in international locations.[221] Extant theory underlines, the location "L" advantages, and the internalization "I" advantages, of natural resource seeking FDI, but does not eagerly consider the role of ownership "O" advantages.

Dunning's Eclectic Paradigm explains that location advantages are the most important determinant factor to explain private MNE natural resources FDI. That is to say, private MNEs choose to internationalize their investments based on a country's location-specific natural resource endowments. Location advantages in this regard are the possession of immobile natural resources that are available, cheaper, and more profitable than in the home country.[222]

Dunning asserts that the first type of natural resource seekers, those seeking; mineral fuels, industrial minerals, oil, coal, gas, and metals; are motivated by cost minimization, security of input supplies, and higher quality resources at lower real costs than is possible in the home country.[223] Dunning reasons that internalizing foreign natural resource assets based on an analysis of the location advantages increases a natural resource-based MNE's market competitiveness and profitability.[224] Interestingly, 'security of input supplies' describes the natural resources needs of private MNEs and is not directly extended to imply the fundamental need by countries for natural resource supplies, although the connection is easily made.

To be sure, Dunning's Eclectic Paradigm also allows for additional theoretical insights. Indeed, ownership advantages may participate as determinant factors of MNE behavior and FDI

GPIs, nor to the natural resources sector. Globerman, S. and Shapiro, D. 'Outward FDI and the economic performance of emerging markets', in Sauvant, K., and Mendoza, K. and Ince, I. (eds), *The Rise of Transnational Corporations from Emerging Markets: Threat or Opportunity?* Cheltenham, UK: Edward Elgar, 2008, p. 229.

[220] Dunning, J. H. 2000, see note 196 at p. 164.

[221] Dunning, J. and Lundan, S., 2008, see note 14 at p. 68.

[222] Dunning, J. H. 2000, see note 196 at pp. 174-179.

[223] Dunning, J. and Lundan, 2008, see note 14 at p. 68.

[224] Ibid.

activity. However, the OLI variables dictate that private MNE natural resource FDI is not ripe for ownership advantages in the same way as in other sectors such as, manufacturing and services. It has even been argued that private natural resource producing MNEs do not posses strong firm-specific advantages.[225]

3.4 From Extant Theory to Supplemental Analysis

Dominant theories designed to explain; why, what, when, where and how; FDI is deployed, primarily focus the analyses on private business enterprises from industrialized market economies.[226] However a comprehensive answer as to why *government* controlled investment is deployed depends on answering, what GPIs are, and how they operate. Answering 'what' GPI behavior is, and 'how' GPI behavior is managed, will further a deeper analysis of 'why' government controlled international natural resource investments are increasing.

To explain this increasing trend two specific questions emerge: (1) What are the firm-level determinant factors behind this trend? (2) How do GPIs harness and organize their internationalization FDI activities in the natural resources sector? These two questions explore different causes than both conventional macro-oriented economic and political science analysis. The firm-level causes are the GPI-specific political ownership advantages. GPIs harness and organize their outward FDI via government control.

There are similarities between GPIs and private MNEs, and extant theoretical frameworks are useful in exploring the causes of GPI behavior and FDI activity in the natural resources sectors. However, conventional economic theories often assume-aside non-economic factors, and center the analysis on rational and optimal economic behavior. Conventional economic theories are not fully suited to deal with the increasingly complicated environment of GPI behavior because they fail to adequately incorporate complicated interwoven dimensions of politics, culture, and economics.[227] For example, political ownership advantages do not minimize economic transaction costs. In fact, GPI-specific political ownership advantages permit, and even search for ways to eliminate commercial cost considerations altogether. (This will be discussed further in detail.)

Dunning's OLI framework corrals the proceeding analysis. However, the premise of Dunning's framework must be turned on its side, if not on its head, to accommodate the nature of government control. That is to say, the causes of GPI behavior and FDI activity are not based

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[225] Rugman, S. 'The Theory and Regulation of Emergin Market Multinational Enterprises', in Sauvant, K., and Mendoza, K. and Ince, I. (eds), *The Rise of Transnational Corporations from Emerging Markets: Threat or Opportunity?* Cheltenham, UK: Edward Elgar, 2008, pp. 76-80.

[226] Dunning, J. and Lundan, S, 2008, see note 14 at p. 63.

[227] Hosseini, H. 'An Economic Theory of FDI: A behavioral economics and historical approach', *Journal of Socio-Economics*, Volume 34, Issue 14, August 2005, pp. 528-541.

on free-market forces—the causes are based on advantages that stem from government ownership and political forces. Therefore, Dunning's framework can only offer a pathway into the analysis, and can neither address nor capture all of the salient features at issue to light the way to a comprehensive answer. There are two primary reasons that an expanded theoretical framework is necessary: (1) GPIs are government controlled. (2) GPI investment objectives are not solely commercial.

Therefore, the determinants of developing and transition country GPI behavior and FDI activity in the natural resource sectors is explained by the interplay between the Eclectic Paradigm's OLI framework, and a GPI's relationship with its home government.

3.5 A GPI's Relationship with the Home Government Determines its FDI Outflows

A firm-level explanation for the causes of GPI behavior is derived from an investigation into the *extent* of government control over a GPI, and the *nature* of government influence on the development of FDI activity.[228] The *extent* of government control becomes evident through a deeper examination of a GPIs relationship with its home government.[229] A GPI's internationalization objectives advance because of the advantages derived from the *nature* of government influence. The relationship between a home government and a GPI's outward FDI allocation decisions is affected in two ways: (1) The extent of government control over GPI-governance directly embeds political influences in the firm. (2) Political influence ensures a degree of politically motivated outward FDI objectives.

To varying degrees, SOEs and SWFs are controlled by, and are therefore an extension of, their home governments. Government control ranges from full to partial influence, and may be exercised through tight administrative mechanisms, or it may be somewhat more selective and loosely controlled by indirect measures such as administrative fiat.[230]

As a result of government control, GPIs reflect a wider array of investment objectives compared to private MNEs. Business, economic, social, and political objectives are all integral factors.[231] Importantly, the political influence over GPI behavior that leads to politically

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[228] VanTulder, R., 'Toward a Renewed Stages Theory for BRIC Multinational Enterprises? A Home Country Bargaining Approach' in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, Palgrave Macmillan, 2010, p. 64. and, Buckley, P. J., Clegg, J. Cross, A. R., Liu, X., Voss, H., Zheng, P. 'The Determinants of Chinese Outward Foreign Direct Investment', *Center for International Business (CIBUL), Leeds University Business School, University of Leeds*, Westminster Research from the *Journal of International Business Studies*, 38 (4). pp. 499-518, 2007, p. 4.

[229] VanTulder, R., 2010, see note 177 at p. 64.

[230] Buckley, P. J. et al, 2007, see note 298 at p. 3.

[231] UNCTAD, 'Non-Equity Modes of International Production and Development, Table I.8', *World Investment Report*, 2011, p. 34. and, Buckley et al writes in a first-of-its kind empirical study on the determinants of Chinese outward FDI and not of developing country FDI in the extractive sector by GPIs per se. I have extrapolated his findings somewhat to portray developing and transition economy GPIs. Buckley, P. J., Clegg, J. Cross, A. R., Liu, X., Voss, H., Zheng, P. 'The Determinants of Chinese

motivated FDI is not *judged* under the rubric of a firm-level GPI analysis. Right or wrong—it simply is. The next section will discuss the extent of government control and the following section will discuss the nature of government control and the impact on a GPIs investment objectives.

3.5.1 The Extent of Government Control over the Exercise of Firm-Governance

A clear difference between a GPI and a private MNE is rooted in the government influence over a firm's decision-making processes. To varying *extents* governments exercise influence over GPIs in many ways. However, one important commonality exists across different countries and across both SOEs and SWFs operating in the natural resource sectors. That commonality is, government influence over GPI-governance. For example, affecting or appointing a GPI's board of directors, chief executive officer, and management, is often an official government function.[232] The government's influence over GPI management is informed by multiple needs, inevitably embodying political forces.[233] Management appointments may be in response to a national or government need, and may override the specific business responsibilities of a GPI.[234]

For example, Chinese SOEs have a parallel political management structure that influences business management. The political management is called the party committee, headed by a party secretary. The party secretary has power over the SOE's business management personnel. This tightly government-controlled administrative structure has direct implications on FDI strategy.[235] Other forms of direct control over SOEs include things like government imposed FDI approval processes and capital controls.[236]

In addition, a more loose set of governance controls is on display when politically semi-independent GPI management seeks political favor, or business rewards, by making decisions that generally pursue national policy objectives as opposed to specific business aims. Furthermore, the nature of control that a GPI exerts on its foreign affiliates will depend on

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Outward Foreign Direct Investment', *Center for International Business (CIBUL), Leeds University Business School, University of Leeds*, Westminster Research from the *Journal of International Business Studies*, 38 (4). pp. 499-518, 2007, pp. 3-4.

[232] Frederick, W., 'Enhancing the Role of the Boards of Directors of State-Owned Enterprises', OECD Corporate Governance Working Papers, No. 2, OECD Publishing, 2011, p. 9.

[233] VanTulder, R, see note 177 at pp. 63-65.

[234] Frederick, W., see note 232 at p. 10.

[235] Hurst, L. 'Comparative Analysis of the Determinants of China's State-owned Outward Direct Investment in OECD and Non-OECD Countries', *China & World Economy*. p. 80. see also, Morck, Randall, Bernard Yeung and Minyuan Zhao, **"**Perspectives on China**'**s outward foreign direct investment,**"** Journal of International Business Studies, Vol. 39, No. 3, 2008, pp. 337–50.

[236] Buckley, P., Clegg, J. Cross, A. Voss, H. 'What Can Emerging Markets Learn from the Outward Direct Investment Policies of Advanced Countries?' in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, Palgrave Macmillan, 2010, p. 257.

careful government control. GPIs are more likely to be ethnocentric firms, as opposed to private MNEs. That is, a GPI will operate to centralize all decision-making in the parent company.[237]

Whereas ownership advantages are mostly irrelevant to the analysis of private MNEs involved in natural resources sector FDI, the disparate ownership structure between GPIs and private MNEs is an important reason to consider the applicability of GPI-specific political ownership advantages advanced through internationalization and internalization. But before an examination of the four unique political ownership advantages can add to a better understanding of GPI behavior and outward FDI activity, it is next incumbent to identify the variety of investment objectives that government control encourages.

3.5.2 A GPI's Investment Objectives are Different Because of the Ownership Structure

GPIs are, broadly and generally speaking, motivated to maximize profits from outward FDI, similar to private MNEs. But because of their government ownership structure, they are also directed to pursue other diverse political government-led objectives.[238] The *nature* of government control exerts pressure on GPI investment to pursue non-commercial objectives. This reality is sometimes reflected by the response to high-profile FDI projects by SWFs and SOEs. For example, in 2008 the Australian treasurer responded to the 9% purchase of Australia's mining company Rio Tinto, by China's SOE aluminum corporation Chinalco, by saying that the Chinese investment must be commercial and business oriented investment and it must not be to advance strategic political ends.[239] Diverse investment objectives have also been noted by leading policy analysts. In a recent 2011 Brookings Institution Study, Darrell West et al asked, and partially concluded:

> "The common characteristics, of foreign government ownership or management of SWFs and other state entities (SOEs) that deploy capital on a global basis, has prompted some observers to question whether geopolitical interests influence investment decisions. For example, China's enormous surge in global investments in mining, minerals and energy assets is seen by some as a new, defining feature of its FDI policy. . . The geopolitical and strategic rationale for foreign direct investment by SWFs and other state actors (SOEs) is an entirely legitimate subject of analysis. While some state investing entities in China are particularly focused on the energy and natural resources sector, it is

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[237] For a discussion of 'ethnocentric' see, 'A Strategic Approach to Decision Making' in, Dunning, J. and Lundan, S. *Multinational Enterprises and the Global Economy*, Cheltenham, UK: Edward Elgar Publishing Limited, second edition, 2008, p. 252.

[238] This sentiment is shared by many observers of developing country GPI behavior and FDI especially with regards to SOEs and SWFs. see generally, Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, Palgrave Macmillan, 2010. see specifically, Drysdale, Peter and Christopher Findlay, 'Chinese foreign direct investment in the Australian resource sector,' in Ross Garnaut, Ligang Song and Wing Thye Woo, eds, China's Place in a World in Crisis, Canberra: ANU E Press, 2009, pp. 349-388.

[239] Hurst, L., see note 141 at p. 80.

difficult to discern an overt political agenda in the investing activities of the world's most prominent SWFs and GPIs."[240]

The reality is that GPI investment objectives *are* more diverse than those of private investors, and they reflect more than just commercial aims. FDI strategies from GPIs include a combination of, economic, political and social aspirations because of the influence exerted by government stakeholders. Conventional economic and international business analysis is reluctant to model the variety of GPI investment objectives. This is because these objectives go beyond the abilities of neoclassical-based models. Neoclassical models rely on rational economic actors and the efficient risk-reward economic behavior of commercially oriented agents. But GPIs engender an alternative, political governance-political objective, matrix.

Indeed, Dunning himself identifies the need to understand the evolving causes of MNE ownership patterns on investment objectives due to the emergence of many new and increasing forms of investment activities. Dunning identifies, alliance capitalism, non-equity modes of international investment, cooperation, globalization's impact on the dynamic nature of business activity, and new economic and political global realities.[241] The global reality that GPIs now display is a new form of all the evolving causes Dunning identifies, especially alliance capitalism.

Alliance capitalism is commonly used to describe the international political economy of private firm-to-firm strategic relationships that are designed to enhance a firm's capabilities.[242] However, GPIs now interact on a GPI-to-firm basis, or on a GPI-to-GPI basis, or even on a GPI-to-host government basis, through increasing international natural resource sector direct investment. GPI outward FDI helps secure global "network-based political affiliation".[243] This is not to say that all GPI investments are alliance-seeking investments, or that none of the natural resource sector FDI is commercially based, it is only meant to illustrate that there are non-commercial, and in fact political motives to GPI behavior and outward FDI activity. And these political motives are not covert, but rather overtly acquainted with international cooperation.

Therefore, GPIs measure the success of FDI activities differently. Commercial and economic objectives are not always preeminent. Instead, economic objectives are accompanied by geopolitical considerations. This is because the success of GPI outward FDI is not simply measured commercially or economically, but also politically.

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[240] West, D. et al, see note 99 at p. 13.
[241] Dunning, J. and Lundan, S., 2008, see note 14 at pp. 113-115, and p. 276.
[242] Haberly, D. 'Strategic Sovereign Wealth Fund Investment and the New Alliance Capitalism: A Network Mapping Investigation', *Environment and Planning*, January 2011, p. 5.
[243] Ibid.

3.6 Internalization is the Link Between GPI Behavior and Outward FDI Activity

GPI-specific political ownership advantages stem from centralized political decisions and assertive political influence by the home government.[244] Internalization is the mechanism that serves to utilize and enhance these advantages. In actuality, internalization is sometimes the only way to exercise GPI-specific political ownership advantages. To better understand the link between GPI behavior and outward FDI activity, in other words, between government ownership and the political advantages of outward FDI it is first useful to once again consult John Dunning and his Eclectic Paradigm, regarding internalization:

> "The generalized predictions of the eclectic paradigm are straightforward. At any given moment of time, the more a country's enterprises—relative to those of another—possess desirable O (ownership) advantages, the greater the incentive they have to internalize rather than externalize their use, the more they find it in their interest to access or exploit them in a foreign location, then, the more they are likely to engage in outbound FDI."[245]

However, (and as Dunning has also noted), ownership advantages are not always static. That is to say, the incentive to internalize is driven both by a GPI's existing ownership advantages and by the desire to obtain new ownership advantages. This is particularly true of GPIs.

Why do government controlled GPIs choose to own international activities abroad, as opposed to simply exploiting their GPI-specific political ownership advantages on the open market, in arms-length transactions? Traditional internalization theory further details a simple answer, that turns complicated in its deficient explanation of government controlled GPIs.[246] Internalization theory posits that if the transaction and coordination costs, of buying and selling between independent producers and suppliers on the open market, are greater than the costs of organizing the same functions within the firm, then the firm benefits from outward FDI expenditures to gain internal ownership.[247] Market functions that can be costly on the open international market become less costly and beneficial once internalized.[248]

From a purely economic approach, ownership advantages need to recompense for all risks attached to investing in a foreign economic, business, political, and cultural environment—"the

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[244] Van Tulder does not use the term 'political ownership advantages'. Indeed he writes of government influence creating market advantages. Van Tulder, R. 'Toward a Renewed Stages Theory for BRIC Multinational Enterprises? A Home Country Bargaining Approach', in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, New York, NY: Palgrave Macmillan, 2010, p. 64.

[245] Dunning, J. and Lundan, S., 2008, see note 14 at p. 100.

[246] Dunning, J. H., 2000, see note 196 at p. 179.

[247] Ibid.

[248] Buckley et al. describe these benefits succinctly with regards to private MNE internalization. Buckley, P., Clegg, J. Cross, A. Voss, H. 'What Can Emerging Markets Learn from the Outward Direct Investment Policies of Advanced Countries?' in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, Palgrave Macmillan, 2010, p. 249-251.

liability of foreignness".[249] Individual costs spring from a variety of components, including, information uncertainty, negotiation costs, host government procurement liability, regulatory uncertainty, prohibitive financial capital costs, and of course little or nonexistent access to natural resources at home. These all create a disadvantageous or desperate market position. A weak market position guarantees home country domestic firms pay a premium for natural resources on the open market. Disadvantageous transaction costs are a result of a weak international economic market position.[250]

Political ownership advantages neutralize many of the potential transaction costs associated with international investment. In addition, without internalization, a GPI's political ownership advantages may be impossible to successfully exploit by buying and selling in arms length transactions on the open market. Without also expanding the internalization of certain operations through outward FDI, GPIs may still find it too costly and less beneficial to obtain natural resources.

In order to realize the benefits and minimize the costs, governments strengthen the international market position of their GPIs by owning and internalizing the coordination of international natural resource production.[251] GPI-specific ownership advantages rely on the political resources that government control enables. Internalization allows a GPI to fully exploit these advantages.

But there is a fundamental reason government controlled GPIs internalize markets other than in an attempt to minimize market-oriented transaction costs. By internalizing market-forces, a GPI seeks to further enhance its position with which to disregard transaction costs altogether. By internalizing international market-forces, a GPI is able to fully exploit its political version of success, and is no longer beholden to an economic version of failure. This cause of outward FDI is a direct result of the advantages of internalization and indeed only possible through the deployment of outward FDI to capture, within the firm, what would otherwise be market oriented transactions and the costs associated. This phenomenon is referred to here as GPI-specific management advantages, and will be further outlined after an introduction to the four GPI-specific ownership advantages.

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[249] Buckley, P., Clegg, J. Cross, A. Voss, H. 'What Can Emerging Markets Learn from the Outward Direct Investment Policies of Advanced Countries?' in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, Palgrave Macmillan, 2010, p. 249-251.

[250] As a note, This argument is based on Dunning's Eclectic Paradigm of the internalization strategies of private MNE's. Existing theory supports the economic reasons, but does not directly support the political reasons, included above for the internalization by GPIs in the natural resources sector. Dunning, J. H. 'The Eclectic (OLI) Paradigm of International Production: Past, Present and Future', Int. J. of the *Economics of Business*, Vol. 8, No. 2, 2001, p. 177.

[251] As a note, I have stretched Dunning's theory here to describe the behavior of governments. Dunning, J. H. 'The Eclectic (OLI) Paradigm of International Production: Past, Present and Future', Int. J. of the *Economics of Business*, Vol. 8, No. 2, 2001, p. 177.

3.7 Detailing Four GPI-Specific Political Ownership Advantages

GPI's are increasingly engaging in natural resource FDI because of the political ownership advantages that government control provides vis-à-vis rival natural resource MNEs. Because of the alternative risk-reward matrix that political influence creates—i.e. elevating political objectives over economic motives—the accumulation of political assets helps to decide a GPI's success. For this reason the cause of GPI behavior and outward FDI is directed towards achieving the political success that a government's political control encourages and provides and is also directed towards obtaining additional political ownership advantages that will achieve political success in the future.

GPI-specific political ownership advantages are realized through a modified version of what existing theory calls, "the resources-based view"[252], "the dynamic O advantages",[253] and "firm specific advantages".[254] Ownership advantages are broadly described by these overlapping theories as; valuable, rare, and hard to emulate capabilities and competences;[255] ; asset augmenting capabilities; proprietary tangible and intangible assets;[256] and, unique firm advantages that competitors cannot access.[257]

Specifically, government control provides four proprietary GPI-specific assets, not available to private MNEs that are deployed internationally to achieve current and future political success. A detailed examination of the four GPI-specific ownership advantages elucidates the discussion. In addition they will help reveal consequential characteristics of politically motivated outward FDI. The four GPI-specific ownership advantages are: (1) political management advantages, (2) unique access to political information advantages, (3) political leverage advantages, and (4) the advantages of unique access to government financing. The unique government ownership structure of a GPI provides it direct access to the full political resources of the home government.[258]

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[252] Penrose, E. T. *The Theory of the Growth of the Firm*', Oxford: Basil & Blackwell, 1950.
[253] Dunning, J. and Lundan S., 2008, see note 14 at pp. 120-122.
[254] As a note, there is disagreement over the ability of private MNE natural resources firms to generate firm specific ownership advantages. See generally, Alan M. Rugman's FSA and CSA Framework. Rugman, A. 'The Theory and Regulation of Emerging Market Multinational Enterprises', in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, New York, NY: Palgrave Macmillan, 2010, p. 75.
[255] Penrose, E. T. *The Theory of the Growth of the Firm*', Oxford: Basil & Blackwell, 1950.
[256] See footnote 157 from, Dunning, J. and Lundan, S. *Multinational Enterprises and the Global Economy,* Cheltenham, UK: Edward Elgar Publishing Limited, (2nd edn.), 2008, p. 120.
[257] Taylor, H., Nolke, A. 'Global Players from India: A Political Economy Perspective', in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, New York, NY: Palgrave Macmillan, 2010, p. 156. see also, Wernerfelt, B. 'A resource-based view of the firm'. *Strategic Management Journal*, 5(2): 1984, pp. 171-180.
[258] As a note, Buckley et al. discusses, with regard to Chinese SOEs, some but not all of the advantages listed, Buckley, P. J., Clegg, J. Cross, A. R., Liu, X., Voss, H., Zheng, P. 'The Determinants of Chinese Outward Foreign Direct Investment', *Center for International Business (CIBUL), Leeds University Business School, University of Leeds*, Westminster Research from the *Journal of International Business Studies*, 38 (4). pp. 499-518, 2007, p. 8.

3.7.1 Management Advantages Determine a GPI's Internationalization Activity

The first GPI-specific ownership advantage that government control provides is the politically oriented investment objectives that political management advocates. A GPI's internationalization through FDI intends to, exploit existing, obtain additional, political ownership advantages by supplanting external market forces in a host economy with its own management structure. A government's control over a GPI augurs specific political-management advantages that reduce market forces once a GPI internalizes international natural resource assets.

In essence, GPIs layer political hierarchy on top of corporate hierarchy to realize benefits and minimize costs of outward FDI in the natural resources sector. However, this contradicts most internationalization theory centered on an analysis of private MNEs. From an economic point of view, internalizing bulky management within the firm, which was previously coordinated by market oriented transactions, can lead to weaker incentives, goal displacement, agency problems, and shirking.[259] Incentive structures affect the costs incurred and the efficacy of the transaction.[260] This is particularly true when bureaucratic hierarchy merges with firm management. In this regard, and somewhat inversely, internalization theory further supports the argument that a GPI's cost benefit matrix cannot simply be economically driven, and the ownership advantages that government provides cannot simply be transaction-cost oriented.

The internationalization benefits of government involvement must include a measure of political success that outweighs any economic failure. Political management that draws on objectives to secure global political cooperative relationships are equally important to a GPIs success. Political cooperation is the best way for a GPI, and by extension the home government, to succeed at augmenting existing political ownership advantages to ensure future benefits from outward FDI.

This conclusion has substantial implications on the effective application of theoretical explanations of emerging economy GPI behavior in natural resources sector investment. Furthermore, not only is economic analysis alone insufficient to describe GPI behavior but perhaps political variables lead economic success. Capturing an ownership stake of international market forces and market resources through FDI activity, a GPI is allowed to circumvent the rules of the market for more successful government political management and the rules of international cooperative relationships. Internalizing the generation and use of value-added assets, versus buying or selling those assets on the open market from other owners, benefits the

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[259] Dunning, J. and Lundan, S., 2008, see note 14 at p. 117.
[260] Dunning, J. and Lundan, S., 2008, see note 14 at p. 118.

GPI because it allows the government to control outward FDI and foreign production at the same time reorients market forces into political barometers.[261]

GPI-specific political management ownership advantages further show that the cause between this recent rise in GPI behavior and outward FDI activity in the natural resource sectors is due to the political nature of government control.[262]

3.7.2 GPIs Posses Privileged Access To Proprietary Political Information Assets

The second GPI specific political ownership advantage that government control provides is, better access to proprietary political informational assets, not available to competitors. The access to political information advantages, creates an ownership advantage perpetuated by GPI internationalization and FDI activity in the natural resources sector.

A GPI's information ownership advantage is due to the increased certainty that government control provides to a GPI's natural resources FDI projects. Behavioral economics suggests that the concept of bounded rationality substantially bolsters the neoclassical assumptions of rational actors behaving based on perfect information. Uncertainty as opposed to efficiency, determines FDI activity.[263] Perfect information is unrealistic and unattainable, but accumulating better information is attainable and desirable.[264] Emerging economy government knowledge of the international resources sector is likely more comprehensive than that of a private firm.

Information is an asset, and access to better information, is a closely related; valuable, rare and hard to emulate; asset. Information asymmetries produce an unlevel playing field that GPIs can benefit from because of their privileged access to unique government information. This notion does not rely *per se* on the idea that government has "better" or "more" information about the natural resources sector than private MNEs. (although in some cases this may be true) Instead the information simply needs to be unique. That is to say, different in an advantageous manner from the information available to competitors.

Natural resource sector FDI is characterized by, immobile location-specific deposits, nationally owned deposits, dominant large enterprises, high-risk geological exploration and test drilling (research and development), highly capital intensive investments, negotiation-based

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[261] As a note, this is a point extrapolated from Dunning's Eclectic Paradigm. Dunning, J. H. 'The Eclectic (OLI) Paradigm of International Production: Past, Present and Future', Int. J. of the *Economics of Business*, Vol. 8, No. 2, 2001, p. 176.

[262] As a note, Buckley et al. discusses government ownership advantages with regard to Chinese SOEs but does not include SWFs and does not specifically use the term 'GPI-specific ownership advantages'. Buckley, P. J., Clegg, J. Cross, A. R., Liu, X., Voss, H., Zheng, P. 'The Determinants of Chinese Outward Foreign Direct Investment', *Center for International Business (CIBUL), Leeds University Business School, University of Leeds*, Westminster Research from the *Journal of International Business Studies*, 38 (4). pp. 499-518, 2007, p. 6.

[263] Hosseini, H., see note 227 at pp. 528-541.

[264] Ibid.

development agreements, and contract-based operations.[265] Government ownership opens the entire spectrum of political informational resources to a GPI.[266]

There are, two broad, and two specific, reasons that key emerging GPIs benefit from unique information through government control. Broadly, the first reason is that not all developing country governments are in a position to offer unique information to a GPI (or potential GPI) relative to private enterprises. Many developing country governments simply do not have the resources (i.e. skills, finances, negotiation, etc.). Broadly, the second reason is that many developed country governments, those that do have the resources, rely on private MNEs for their information. Developed economies tend to place *relatively more* (compared to key emerging economies) emphasis on the expertise that the free-market generates.

Specifically, the first reason is that governments are better positioned to understand the geopolitical undertones, of global natural resources investment. Natural resource, exploration, negotiation, and regulation, are all rife with political idiosyncrasies. It is true that, "oil is 90% politics and 10% oil".[267] And this is also true of other extractive industries.[268] Although private MNEs are competitive when markets are based solely on economic factors, they struggle to understand the global political mood, relative to governments. This leads to the second specific reason.

Key emerging economy governments are better positioned to act on their global political understanding of the natural resources sector to the benefit of their natural resources-based GPIs. Private MNEs need to lobby their home country politicians to further their interests. Private MNEs need to consolidate information based on the opportunities they have identified from the open market regarding the international natural resources sector. The ownership structure of a GPI, on the other hand, naturally embodies this information and can act organically on unique political information.

These reasons exemplify the political information advantage that government control provides to key emerging market GPIs. Therefore, key emerging market GPIs, in the natural resources sector, are uniquely informed and thus more successful internationally, compared to other MNEs and GPIs from both emerging and developed economies.

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[265] As a note, the European Commission presents a general overview of the natural resources sector characteristics on its website. This overview by no means comprehensively lists the characteristics listed here. European Commission. www. epp.eurostat.ec.europa.eu, available at, <http://epp.eurostat.ec.europa.eu/statistics_explained/index.php/ Mining_and_quarrying_statistics>

[266] As a note, Van Tulder makes the general point but does not specifically list information. VanTulder, R., 'Toward a Renewed Stages Theory for BRIC Multinational Enterprises? A Home Country Bargaining Approach' in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, Palgrave Macmillan, 2010, p. 68.

[267] Yergin, D., *The Prize: The Epic Quest for Oil, Money, and Power* New York, NY: Simon and Schuster, 1991.

[268] Kraemer, R. Van Tulder, R., see note 198 at p. 139.

However, access to unique information alone is not enough. The accumulation of information assets has value primarily when combined with other political capabilities owned or controlled by a GPI.[269] Therefore the ultimate value of better information depends on how the information is utilized or augmented by an emerging economy GPI.[270]

3.7.3 GPIs Posses Privileged Access To Proprietary Political Leverage Assets

The third GPI-specific political ownership advantage that key emerging economy natural resource-based government-controlled GPIs enjoy over private MNEs or GPIs from other countries is increased political leverage. This leverage is based on the government's international relationships and reputation. Emerging economy natural resource-based GPIs benefit from the available political relationships, political "brand name", and the increased bargaining power that government backing provides.[271]

Emerging economy governments, especially the BRICs, have become renowned for their economic growth over the last decade. This has attracted attention on every level, political, economic, social, cultural, etc. It has especially attracted inbound investments from around the world, and has increased the political position of the BRICs globally. The political and economic relationships that have been built based on this elevated global position, can be leveraged by the natural resource-based GPIs from the BRIC countries when investing and operating abroad. Because the BRIC economies have gained a reputation as increasingly favorable places to invest, and have therefore increasingly been viewed as an important political presence on the global stage, the reputation that BRIC governments have fostered, and continue to foster, helps determine the success of their GPI's internationalization outward FDI strategies. A good international reputation provides political leverage advantages that accrue to a GPI operating abroad in natural resource sectors.

Political leverage advantages are evidenced by recent GPI behavior and FDI activity. GPIs pursue international partnerships and fortify strategic international alliances that are intended to support economic or political ends.[272] GPIs design FDI activity around the strategic distribution of natural resources, especially oil and gas—further evidence of alliance seeking FDI or alliance

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[269] Dunning, J. and Lundan, S. *Multinational Enterprises and the Global Economy*, Cheltenham, UK: Edward Elgar Publishing Limited, second edition, 2008, p. 121. This sentiment is described by, "The Knowledge-Based Theory" of ownership advantages relayed by Dunning in relation to private MNEs.

[270] Dunning, J. and Lundan, S. *Multinational Enterprises and the Global Economy*, Cheltenham, UK: Edward Elgar Publishing Limited, second edition, 2008, p. 121. Again, this is a conclusion based on the theory of private MNEs.

[271] As a note, Van Tulder considers the bargaining position of BRIC country governments. Van Tulder, R., 'Toward a Renewed Stages Theory for BRIC Multinational Enterprises? A Home Country Bargaining Approach' in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, New York, NY: Palgrave Macmillan, 2010, p. 65.

[272] UNCTAD 2011, see note 2 at p. 56.

capitalism.[273] GPIs seek partnerships through outward FDI to attract additional outside investment to increase the impact on the host economy.[274] GPIs use relationships built through outward FDI as a means to attract value-added inward FDI in reciprocity.[275] GPIs make current investments in lower-cost locations for *future* operations in natural resource extraction due to political considerations, i.e. election cycles or demographic trends, despite cheaper current domestic access to the same natural resources.[276]

In addition to the advantageous leveraging of a governments "brand name" through political-ownership, GPIs also exercise political leveraging ownership advantages by directly implanting government influence in a foreign country through outward FDI.

Perhaps the most widely discussed effect on the relationship between an MNE engaged in natural resource FDI and the host country is the "obsolescing bargain" first identified by Raymond Vernon in 1971.[277] This phenomenon describes the change in bargaining power or leverage between investing firms and the host governments over time.[278] Although natural resource investors have a strong position with which to bargain at the outset, this position weakens considerably once the investment has been made. Companies spend millions of dollars and navigate substantial risk and uncertainty and therefore require favorable treatment upfront. However once the capital is sunk, investors are at the mercy of host authorities.[279]

Political leverage ownership ensures that any threat of action, or direct action taken to nationalize foreign investment by host authorities, is now nearly a direct act against a foreign government. Government controlled GPI natural resource investment ensures that any political ramifications of such actions are more intense and less favorable for the host countries, and therefore nationalization risk is mitigated to the advantage of a GPI.

3.7.4 GPIs Posses Privileged Access to Government Financing

The fourth GPI-specific political ownership advantage that helps to determine GPI internationalization strategies in the natural resource sectors, is found in a GPIs privileged access to large and consistent sources of government funding. To the extent government funding is secure and reliable, GPIs maintain a source of funding not available to their private MNE

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[273] As a note, for a detailed discussion of the many varied motivations of Russian MNEs in Africa see, UNCTAD, 'Non-Equity Modes of International Production and Development, Chapter II, Regional Investment Trends, Box II.3', *World Investment Report*, 2011, p. 67. Alliance capitalism is described by Dunning and Lundand in, Dunning, J. and Lundan, S. *Multinational Enterprises and the Global Economy*, Cheltenham, UK: Edward Elgar Publishing Limited, second edition, 2008.
[274] UNCTAD 2011, see note 2 at p. 56.
[275] Ibid.
[276] OECD, see note 112 generally.
[277] Vernon, R. *Sovereignty at Bay*, New York, Basic Books, 1971.
[278] Moran T, see note 167 at p. 18.
[279] Ibid.

counterparts and their less fortunate emerging economy peers.

The difference between private MNEs and GPIs in this regard is clear. Private MNEs are funded primarily by; reinvested earnings, private lines of credit, and by raising private equity and debt capital. Many GPIs on the other hand are financed to a large extent by government capital. This capital seeds from, foreign exchange reserves established through trade surpluses, and foreign exchange reserves established through excess nationally owned natural resource revenues.

GPI government ownership advantages stem from the, governance—investment objective matrix, that then bestows privileged financial funding on the firms best positioned to take advantage of the unique ownership structures and objectives. To be sure, it is debatable the extent to which the government controls the various types of firms that receive beneficial excess foreign exchange reserves. Some countries provide these funds to "national champions", the independence of which is arguable. Nonetheless it is clearly a function of government influence and an advantage to receive public funds for the purpose of international expansion. And many of the firms that receive the benefits of these funds are clearly government owned, SOEs and SWFs alike.

Importantly, subsidization and similar forms of special government financial support are distinct, and are not necessarily a direct result of the special financial ownership advantages that government control provides. Subsidization is not necessarily a form of ownership advantage because many emerging economy firms receive subsidization benefits from the government regardless of government ownership.

In addition, there are financial advantages that appear as mitigated disadvantages. GPIs that are economically inefficient in foreign markets may survive because their political-financial ownership advantages make it impossible for domestic debt holders, such as financial institutions, to impose financial penalties when losses occur.[280] In other words, and in the extreme, the government owners of a GPI may pass laws, or disregard existing laws to protect GPIs from market forces that would otherwise enact commercial dissolution.

As opposed to Dunning's view of the commercial viability of private MNE natural resource outward FDI, a fundamental driver of GPIs successful FDI activity vis à vis private competitors is "moral hazard". Moral hazard takes many forms. For example, the advantageous potential of a GPI to overbid on foreign projects may spring equally from subsidization as it does from financial ownership advantages as well as management's alternative view of the project's risk-reward matrix and subsequent acquiescence to pay beyond market prices. Or moral hazard can also result from guaranteed government funds, reducing the risk of competition and the

[280] Buckley, P. J. et al., see note 208 at p. 506.

economic penalties of economic inefficiency. Moral hazard in this regard is apparent in projects deemed attractive by the government, but not necessarily most profitable.[281] This market-unoriented view is funneled through GPI management by the government-involved governance structure. In other words, the advantageous political government financing ownership advantage may include limited fear of financial failure,[282] commonly known as "moral hazard".

3.8 Conclusion: The Firm-Level Causes of GPI Natural Resource FDI

To determine GPI behavior and outward FDI activity in the natural resource sectors, analysis must ask and answer the question: To what extent does a home government control a GPI, and what ownership advantages does the manner of government control provide? The extent of government ownership and the political ownership advantages determine the pattern of developing economy GPI behavior and FDI activity in the natural resource sectors.

Political management advantages and the advantages of unique access to government financing point to causes that relate to the desire of GPIs to exploit and create economic market dislocations and imperfections in both the home and host economies.

However, the unique access to political information advantages, and the political leverage advantages, point to causes of GPI outward FDI in natural resources that hinge on cooperation between GPIs and private firms, cooperation between GPIs and other GPIs, as well as GPIs and host country government authorities. In essence, the cooperation that is critical to a GPI's success is cooperation between home and host country governments.

4. The Effects of GPI Behavior and Outward FDI Activity in the Natural Resources Sector

4.1 Introduction

> "The relevant question for contemporary developing and developed country authorities, as well as for multilateral lending agencies and international civil society groups and NGOs, is how to promote FDI in the extractive sector in ways that generates economic growth as well as strengthens good governance."[283]

Policies that generate economic growth and strengthen good governance are possible only if the causes and effects of outward FDI in the natural resource sectors are fully understood. Chapter 3 argued that a firm-level understanding of the causes of GPI behavior and FDI activity reveals a missing element. While acknowledging the economic causes of increasing outward FDI by emerging economy GPIs in the natural resource sectors, chapter 3 highlighted the

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[281] Buckley, P. J., Clegg, J. Cross, A. R., Liu, X., Voss, H., Zheng, P. 'The Determinants of Chinese Outward Foreign Direct Investment', *Center for International Business (CIBUL), Leeds University Business School, University of Leeds*, Westminster Research from the *Journal of International Business Studies*, 38 (4). 2007, p. 506. see also, Ma, X. and Andrews-Speed, P., 'The overseas activities of China's national oil companies: rationale and outlook', *Minerals and Energy* 21(1): 2006, pp. 17-30.
[282] Buckley et al. describe this phenomenon but not in 'financial ownership' terms. Buckley, P. J., et al, see note 208 at p. 506.
[283] Moran T., see note 167 at p. 10.

political causes based on a firm-level analysis. A GPI's unique, access to political information advantages, and political leverage advantages, indicate a remarkable degree of international cooperation that GPIs need and desire in order to be successful. This perspective has an impact on how to view the effects of this recent phenomenon and by extension how to best promote FDI.

The effects of increasing outward FDI by emerging economy GPIs in the natural resource sectors are both economic and political. A detailed examination of the economic effects of this new trend is beyond the scope of this chapter. Nonetheless, an overview of the economic effects, lead to the political cooperation effects that this chapter seeks to highlight.

Analyzing the economic causes often takes analytical precedence. Therefore, analyzing the economic effects becomes natural. Unfortunately, evaluating the economic effects of increasing GPI outward FDI alone portrays a daunting picture. However, incorporating an understanding of the firm-level political effects, offers a more positive view. Understanding the economic effects of increasing emerging economy outward FDI is tantamount, but it cannot be judged without simultaneously understanding the political effects.

There is a long and distinguished history of theoretical tools to describe the firm-level causes and effects of FDI. Chapter 3 attempted to remain loyal to existing theory while applying supplemental analysis. An evaluation of the *effects* of the recent trend in GPI outward FDI in the natural resources sectors must take a decidedly descriptive approach. The following chapter will proceed with a general analysis of three select effects of this new trend in descriptive and informed fashion. The three effects are: (1) economic effects, (2) the geopolitical effects, and, (3) the potential for further cooperation effects that are evident from the preceding firm-level analysis of political ownership advantages. In addition, it is necessary to incorporate cooperation effects to address the current economic and geopolitical effects. Cooperation is made possible by the political causes that a firm-level analysis reveals.

4.2 New Trends in GPI Natural Resources Sector FDI Effect Natural Resource Prices

Government control affects a GPI's natural resource investment decision-making in a manner that can elevate the importance of acquiring political assets over economic efficiency. Political management advantages, and the advantages of unique access to government financing, indicate that some of the causes, behind a GPIs outward FDI to the natural resource sectors, exploit and create economic market dislocations and imperfections in both the home and host economies. As the demand for these two political assets increases (referred to here as "political demand"), through increasing natural resource sector outward FDI, natural resource investments will increasingly fail to reflect economic price discovery. Increase political demand will cause a

shift in demand for natural resources, which in turn will increase prices.

The market for natural resources is a global market.[284] Unlike the market for national or regional products, effects on the prices for natural resources are felt globally. The impact on the global market will depend on the degree of price distortions (i.e. how big are the non-market effects on prices?) In addition, in the short-run, supply and demand in the natural resource markets are both relatively inelastic. Large changes in price will not be met by proportionally large changes in either supply or demand. Similarly, small changes in the short-run supply or demand for natural resources will cause disproportionally large changes in price. In the long-run increases in demand are thought to be met by new capital investment from companies that enter the market to take advantage of persistently high short-run prices. Similarly, it is believed that long-run demand for natural resources can adjust to the persistently higher short-run prices.

This conventional wisdom is revealing both for its useful analytical impact, and because it is incomplete. There are five salient features of the natural resource sectors that are generally important to keep in mine. These are not always captured by the conventional economic rubric. (1) Natural resources are exhaustible. (2) Natural resources are often complimentary. (3) Even in the long-run, the substitutability of natural resources is debatable. (4) While natural resource markets are global,[285] the extraction points are immobile and location-specific. (5) Natural resource, extraction and production, is characterized by a small amount of very large firms with oligopolistic control— approaching monopoly control.[286]

4.3 An Increase Demand Shift

An increase shift in demand fundamentally reflects both the expansion of economic growth and the alternative politically oriented risk-reward matrix of GPI outward FDI allocation. Political demand is unrecognized. Political demand represents new demand for natural resources. The effects of political demand on prices will depend on the proportion of political demand.

Following from the previous analysis, the causes of increasing GPI investment in natural resources is due to the increasing ability of a GPI to benefit from GPI-specific ownership advantages that derive from the proprietary political assets unique to the government of a specific country. And, GPI outward FDI benefits from the political ownership advantages that government control provides. Because of these advantages, new demand for natural resources

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[284] Nordhaus, W. 'The Economics of an Integrated World Oil Market', *Keynote Address, International Energy Workshop, Venice,* June 17-19, 2009, p. 1.
[285] Nordhaus, W. 'The Economics of an Integrated World Oil Market', *Keynote Address, International Energy Workshop,* Venice, June 17-19, 2009, p. 1.
[286] Kraemer, R. and Van Tulder, R. 'Internationalization of TNCs from the extractive industries: a literature review', *Transnational Corporations,* Vol. 18, No. 1, April 2009, p. 142.

has appeared that goes beyond the typical causes and effects of economic supply and demand.

A GPI might aggressively pursue natural resources through outward FDI with little regard for economic efficiency. Nonetheless there are economic effects. In essence, this particular demand shift is a result of the beyond-economic demand that a GPI's investment represents. If an offsetting shift in supply of equal magnitude is unobtainable, prices will increase to accommodate the outward shift in the demand curve. In other words, the prices of a particularly effected natural resources will reflect a modicum of political equilibrium, above fundamental, economically-oriented price equilibrium. If this demand shift proves to be a long-run increase, then there will be commercial incentive for new production to create increased supply.[287]

However, because of the sector's five specific characteristics listed above, new supply will be difficult to establish. But, that is not all, new supply will also face obstacles created by the same force that created the new demand.[288] That is to say, political demand is inefficient demand and will impact the economically efficient supply of natural resources.

4.4 Shifting Natural Resources FDI Trends Effect Geopolitical Relationships

The geopolitical effects that follow from the economic effects of this new and growing trend—outward FDI in natural resources by GPIs from emerging market economies—are much different than previous waves of FDI expansion.[289] Importantly, understanding the geopolitical effects must be based on both the economic and political causes, in order to best navigate a successful future. A recalibration of geopolitical power and political cooperation is currently a result of outward FDI from emerging economies.

GPI natural resource FDI epitomizes a not-so-small microcosm, that specifically represents two broader shifts in the global political economy: (1) An increasing redistribution of wealth; economic mite, and financial power; from the US, EU, and other developed countries to key developing and transition countries. (2) The increasing role of governments in managing wealth; economic mite and financial power; previously thought to be a small blight, and only a transitory speed-bump, on the path to international economic liberalization.[290] These shifts are likely to persist and investment objectives between private MNEs and GPIs will continue to differ. Cooperation therefore needs to play an important role.

In any case, the minimum natural resource needs, under any environment, proven over time, of wealthy countries together with the sustained needs of developing and transition economies

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[287] Economists View, 'An increase in Worldwide Demand for Oil', *www.economistsview.com* June, 29 2008, available at, <http://economistsview.typepad.com/economistsview/2008/06/an-increase-in.html>

[288] For general reference, Byrnes, R. and Stone, G. *Microeconomics*, Harper Collins: NY, NY, Sixth Edition: 1995.

[289] Thomsen, S. 'Emerging Market Investment: Continuity or Change', in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, New York, NY: Palgrave Macmillan, 2010, p. 460.

[290] Truman M. Edwin, "Sovereign Wealth Funds and the Global Economy: Theater or Salvation?" *PIIE*, September 2010.

for external sources of natural resources, means that cooperation is tantamount to achieve political and economic gains from the increases in natural resources FDI.[291] Furthermore, the *political demand* for natural resources from emerging economies can distort market prices but *can* also have a positive economic development effect, or at least an ameliorating effect, on economic turmoil throughout the world if adequate cooperation is achieved.[292]

Political forces provide GPI-specific ownership; management, information, leverage, and funding, advantages. Firm-level analysis highlights the criticality of political cooperation to the success of GPI natural resource FDI. Without international political relationships the GPI-specific ownership advantages would disappear. Political ownership advantages are not fostered through political estrangement. Ripping-off political counterparties does not nurture the political forces that create GPI-specific ownership advantages. Success is built on collaboration. While the economic effects are daunting and the geopolitical effects are intensifying, the political firm-level causes reveal effects that point to viable increased international cooperation.

Cooperation is imperative to negotiate the economic shifts that new FDI trends have helped to effect. Therefore, cooperation surrounding FDI is obligatory, and cooperation between host states and emerging economy GPIs engaged in outward FDI in natural resources is urgent.

4.5 The Need for Cooperation

Just as the objectives of GPIs from developing and transition economies engaged in outward FDI in the natural resources sector are different from traditional outward FDI aims, so too is the response from potential FDI host countries dissimilar. Often the nature of the investment is scrutinized. Often the characteristics of the investor and the investor's home country are relevant. But sometimes the objectives and attributes of the investor or investing country are of relegated relevance compared with the blind ambition of host countries to maintain local ownership in a sector or industry.[293] Because this investment is motivated by a myriad of forces, integration and cooperation mechanisms need to play an important role.[294]

In principle, GPI behavior and FDI activity promises higher returns for home countries on the accumulation of surplus reserves, and concomitant higher levels of host country economic

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[291] UNCTAD 2011, see note 2 at p. 68.
[292] Keen, S. interviewed by Ashcroft, R. *Renegade Economist*, beginning at minute 20:55. available at, <http://www.youtube.com/watch?v=7F2FKxxN_IE&feature=player_embedded#!> and, Park, D. and Estrada, G, 'Developing Asia's Sovereign Wealth Funds and Outward Foreign Direct Investment', *Asia Development Review*, Asia Development Bank, vol. 26 no. 2. 2009, pp. 57-85.
[293] Thomsen, S. 'Emerging Market Investment: Continuity or Change', in Sauvant, K. Maschek, W., & McAllister, G. (eds.), *Foreign Direct Investments from Emerging Markets: The Challenges Ahead*, New York, NY: Palgrave Macmillan, 2010, p. 456.
[294] UNCTAD 2011, see note 2 at pp. 67-68.

development.[295] However, whether GPIs can successfully turn this potential into reality is reliant on whether they are effective at adding value through their investments.[296] This then depends on the success of emerging economy outward FDI. Emerging economy GPIs measure success in political terms as well as economic terms. Perhaps host countries should do the same. The receptiveness of host countries, transmitted by the host's policies towards coordination and cooperation, to investment from foreign GPIs is crucial. The greater the ability of GPIs to add value with their outward FDI, and the more comprehensive the host's policies, the likelier GPIs are to succeed at using FDI for much needed economic development.[297]

4.6 Rational Choice Theory as the Basis for Cooperation

Rational Choice Theory posits that a country's rational self-interests are best served through binding international cooperation, particularly international law.[298] Cooperation increases a country's payoffs. A country's compliance and engagement with international law serves to facilitate beneficial cooperation by making international coordination possible.[299] GPI international investment thrives on political ownership advantages that stem from international political cooperation. GPIs are well positioned to accept mechanisms that facilitate international coordination.

International law for example, transforms the messy world of *ad hoc* cooperation between countries, into an exercise of coordination between multiple countries that is focused on maximizing the payoffs of all parties involved. International law then, can be viewed as facilitating cooperation that coordinates a country's self-interests.[300] Countries pursue and comply with binding international agreements when international coordination can maximize their self-interested payoffs. Firm-level analysis of GPI outward FDI to the natural resource sectors elucidates the advantages and the payoffs of political cooperation. Enhancing cooperation through coordination would lead to increased advantages and increased success.

Measuring a country's desire for binding international agreements focuses on when and how they use these mechanisms to serve their national interests, and the subsequent effects on their behavior. Countries benefit from coordinating, and even restraining themselves, vis à vis other countries when it serves their current and/or future interests and payoffs. Dynamics of

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[295] Park and Estrada make this point in specific reference to SWFs. Park, D. and Estrada, G, 'Developing Asia's Sovereign Wealth Funds and Outward Foreign Direct Investment', *Asia Development Review*, Asia Development Bank, vol. 26 no. 2., 2009, pp 57-85.
[296] Ibid.
[297] Ibid.
[298] Guzman, A. *How International Law Works*: *A Rational Choice Theory*, Oxford: Oxford University Press, 2008, pp. 8-13
[299] Ibid. pp. 12-13.
[300] Ibid. p. 16.

reputation, reciprocity, and retaliation, explain how international legal cooperation facilitates coordination.[301]

Through rules, regulations, certainty, and clarity, countries realize payoffs according to the management of reputation, reciprocity and retaliation. Because international cooperation through legal mechanisms is desirable for coordinative purposes, countries protect their reputation by entering into and respecting international legal agreements. Therefore, because countries maximize their payoffs by cooperation, international law acts as assurance and insurance for coordination.

> "Developing a reputation for compliance with international law allows states to capture larger gains from international cooperation. When states enter international agreements and when they make decisions about compliance, they take the relevant reputational consequences into account. Because compliance with international obligations improves a state's reputation, an incentive toward compliance is generated. This incentive toward compliance represents the value added by international law."[302]

Reputation is the fulcrum that weighs a country's ability to extract its international investment payoffs. Through compliance with international law, a country can manage its reputation. In addition a country's reputation is its currency to enter into international investment agreements with other countries in the future.[303] If a country compromises its reputation it will be more difficult to enter beneficial coordination agreements and the beneficial payoffs of cooperation will be at risk.[304] A reputation for compliance with international agreements greases the willingness of counter parties to cooperate and increases the benefits of outward FDI.

In a so-called "one-shot"[305] prisoners dilemma game, states may very well act according to what is best for themselves regardless of accounting for cooperation or the actions of counter-parties.[306] In such a scenario the payoffs will always be greater for a state not to cooperate regardless of how the other state acts. However, the matrix of international relations is rarely a one-shot game, and the prisoner's dilemma only characterizes one of the many coordination problems inherent in international investment relations. International investment requires an ongoing relationship between investor and investee over time. A country's non-compliance with international law, for example, may risk undermining its reputation, and threaten reciprocity and retaliation from other countries, putting investment payoffs in jeopardy.

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[301] Ibid. p. 212.
[302] Ibid. p. 212.
[303] Guzman A, see note 298 at p. 33.
[304] Ibid. p. 211.
[305] Ibid. p. 32
[306] Ibid. p. 30

International law facilitates the complexity of a country's interests by opening a vehicle to coordinate problems of mistrust, fear, and uncertainty.[307] Developing and transition economies are increasingly interested in the payoffs from outward FDI, and GPIs rely on cooperation to create and maintain political ownership advantages that make outward FDI successful. Country's exercise international law to coordinate reputation, reciprocity, and avoid retaliation in order to reap the benefits of cooperation. Utilize this cooperation.[308]

4.7 Conclusion: Effects of GPI Behavior and Outward FDI Activity

The economic effects of GPI behavior and outward FDI in the natural resource sectors can disrupt competition, distort markets, and effectively increase prices. Detrimental economic effects follow from a firm-level analysis of the political financing and management advantages that government control bestows on natural resource-based GPIs. In addition, the geopolitical effects of increased GPI outward FDI are intensifying. The shift in wealth and power is unsettling the geopolitical status quo.

However, firm-level analysis also exposes causes of GPI behavior such as, political leverage and political access to information, that are based on international political cooperation. The effects of these cooperation causes must be seized by developing and developed country authorities, multilateral lending agencies, international civil society groups, and NGOs alike, in order to best promote outward FDI in the natural resource sectors in ways that generate global economic growth and development and strengthen good governance.

5. Conclusion

As set out in the introduction this paper is based on three questions:

(1) Is outward FDI from emerging economy GPIs into natural resource sectors a significant new trend? The component facts that underlie this recent trend highlight the important extent and nature of government control over SOEs and SWFs and their increasing interest in international natural resource investment.

(2) What are the likely causes of this new phenomenon, and what causes can be gleaned from the component facts? The facts indicate that there are reasons for the extent and nature of government control over natural resource-based GPIs. Because causes often cited, skip a firm-level analysis of the political nature of government control, this paper contends that GPI-specific political ownership advantages play an important and overlooked causal role. The likely firm-level causes are; political, management, information, leverage, and funding; advantages for government controlled GPIs. These advantages help GPI outward FDI succeed. While economic

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[307] Baird, Gertner, & Picker, *Game Theory and the Law*, Cambridge, Mass.: Harvard University Press.1994, pp. 33-34.

[308] As a note, this section (section 4.6) has been recreated from a paper I wrote for Professor Andrew Guzman in the early stages of the MILE program. Utter, B. "Legal Theory and Economic Analysis of International Law" Berne, Switzerland: *MILE Program* 2011, pp. 1-5.

success is a factor this paper focuses on the nature of GPI outward FDI success as measured by the political objectives that government control influences.

(3) What effects are evident from an analysis of the facts and the causes? The effects of political causes are; economic, geopolitical, and political. The economic effects might appear daunting, but they do not have to be. The geopolitical effects likewise may appear unsettling, but again, they do not have to be. Because GPIs operate based on significant political cooperation, they welcome international coordination that can address economic issues while facilitating the advantageous payoffs that GPIs rely on.

Despite ongoing financial and economic woes affecting many economies around the world, outward FDI from developing and transition economies is growing. Key developing and transition country outward FDI has increased significantly over the last six years. In particular, developing and transition economies have generated record levels of FDI outflows directed towards the natural resource sectors around the world. The growing importance of FDI outflows from emerging economies is central to the economic growth and development of economies everywhere. Cooperation is the best way to ensure that shifting outward FDI trends promote the interests of both host and home economies.

Emerging economy governments influence FDI outflows to the natural resource sectors. GPIs are becoming more prominent internationally. GPI behavior and outward FDI activity is caused by the political ownership advantages that government control over SOEs and SWFs provides. The many causes of this recent global force are still uncertain, however, firm-level analysis uncovers fundamental international political cooperation needed by GPIs in order to succeed with their outward FDI in the natural resource sectors. This need is nurtured by GPIs through what this paper has called 'political leverage, and political information, advantages'. GPIs seek to create and maintain advantages through cooperation that help their outward FDI succeed.

Emerging economy GPI's need and desire international political cooperation. This is an element of outward FDI from emerging economies that often gets overlooked. Indeed, economic and geopolitical effects are acute, and they should be taken into consideration. However, the desire for cooperation originating from the source of new and increasing GPI outward FDI, can be utilized to facilitate much needed economic growth and development around the world.

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