Home Country Responsibility: Foreign Direct Investors in Less and Least Developed Countries

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Inward foreign direct investment (FDI) plays a crucial role in the economic development of less and least developed countries. While these firms have the potential to positively influence economic development in host countries, they may also become dominant. This can lead to various challenges, such as market distortions, competitive challenges for domestic firms, increased dependency of the domestic industry and fiscal policy on large foreign investors, and potentially adverse social and environmental impacts. Ultimately, the quality of the host country's institutions and governance determine whether inward FDI is a curse or a blessing. This is especially true for natural resource industries. This literature-based theoretical thesis paper argues that the institutional circumstances of least and less developed countries often have negative implications for inward foreign direct investment (FDI), such as weak governance structures and corruption. Therefore, it is imperative that home countries assume responsibility for their investors in these countries so that the right kind of foreign investors lead to a mutually beneficial outcome for investors and the host economy.

Keywords: multinational firms, international business, developing countries, extractive industries, co-evolution of institutions

INTRODUCTION

Least and less developed economies offer viable business opportunities that are often explored through foreign direct investment (FDI). However, such FDI can yield significant market power, be it due to a lack of market-enabling and market-supporting institutions and resources or be it because of gaps in technology and complementary investments (as e.g. physical infrastructure). As profit-seeking entities, foreign investors' managers will naturally seek to reduce costs, including labour unit costs and the use of the natural environment. When the host country's civil society, policymakers, and regulators are unable to effectively counterbalance the influence of powerful foreign investors, and domestic law enforcement is weak, decision-makers are likely to succumb to the temptations of corruption. Moreover, it is typically experts from the home countries of wealthy investors who advise recipient host countries on matters of negotiation with foreign investors. Those challenges are particularly relevant in the natural resources industry, with its mining, refining, and processing activities. It is the richness in natural resources that makes many developing countries attractive to foreign investors. With their established and internationally tested business models, they are able to bridge technological and institutional gaps in host countries on their own. In such cases, foreign direct investors engage in the co-evolution of host country institutions and the

development of local infrastructure (for the most comprehensive analysis of the developmental role of FDI to date, see Moran, 2005).

This paper examines the multifaceted role of FDI operating in developing countries towards promoting development-friendly institutions. Internationalized firms, particularly if they are multinational corporations (MNCs) with a global reach and vast resources, can impact significantly on the conditions of economic activity in their host countries and yet, positive co-evolution of development-friendly institutions is not too often heard of: "Most CEOs of MNEs still support the SDGs [...], and there is no lack of intentions to move the SDG agenda forward. But studies [...] show a sizable gap between intention and realization." (Tulder, 2024, p. 2). And yet, the administrative/political world surrounding the UN's Sustainable Development Goals (SDGs) allocates a leading role to private industry in achieving the SDGs (see, e.g., various publications by CCSI). It is assumed that it is especially foreign investors who, through their superior technology and their partnership with government and civil society, can ensure that natural resource business has a positive impact on the host economy, local communities, and the natural environment during the duration of operation and even beyond (Otto, 2022).

Nevertheless, the question of how foreign investors might be encouraged to take on such a prominent role remains unanswered. How can ESG (Environmental, social, and corporate governance), CSR (Corporate social responsibility), SRI (Socially Responsible Investing/Sustainable and Responsible Investing), and CDA (community development assistance) be made effective for foreign investors? Does this remain in the field of dis-incentives, whereby regulations find punishment for firms that evade fulfilling the role the UN assigned to them (Otto, 2022)? Or can positively embracing CSR lead to a solidification of social license and, hence, render rational investors unnecessary (Ho et al., 2024)?

The analysis delves into International Business theory, Economic Development theory, and Institutional theory literature to shed light on the research question as to whether such foreign investments will tend to produce development-friendly institutions or whether the opportunities of windfall profits and rent-seeking behaviour rather produce the opposite impact: under what conditions will foreign direct investors use their potentials to engage in the co-evolution of development-friendly institutions? Do such conditions exist only in very peculiar circumstances, is it more likely that FDI will produce predominantly negative impacts on their less developed host economies, by using weaknesses in legal enforcement (non-compliance) and institutional voids to their own advantage and possibly even to the detriment of the host location? Positive and negative outcomes of inward FDI are frequently observed in empirical examples. What is missing in the academic discussion, however, is a mapping of what theory holds for predicting a particular outcome by explaining the likely mechanisms at work. It goes without saying that the results of such an analysis can be interpreted in terms of implications for regulators and policymakers – whether they are developing countries themselves or countries offering development aid of some kind.

Drawing upon a heterogeneous set of theoretical frameworks and widespread empirical evidence, this study predicts the mechanisms that determine the balance of the impact of inward FDI on its host economies.

The paper begins with an analysis of the literature's insights into the role of foreign-invested firms in the development of institutions in their host countries. This lays the foundation for an analysis of what motivates foreign investments to contribute to SDGs and to thereby tilt the balance of impacts for FDI towards the development of inclusive institutions in host countries. The third analytical chapter infers that external governance institutions, particularly home country regulators, are necessary to ensure a positive impact. The final chapter concludes by comparing what is already in place in terms of home countries assuming responsibility and what the future of multilateralism holds for developing countries with a weak institutional fabric of their own.

INSTITUTION-BUILDING AND THE ROLE OF INTERNATIONAL BUSINESS

Internationalised firms play a special role in institutional development, as they operate between the institutional design prevailing within their own foreign investor network and the institutions, they find in their host countries. Internationalised firms have developed a particular ability to operate in varying, not

always coherent, institutional fabrics. In particular, in less developed countries with dynamically changing structures, they are likely to have developed routines that include the proactive influencing of institutions. They are in the prime position to guide the process of institution-building, becoming institution-builders par excellence, both in positive and negative terms. This is supported by the International Business (IB) theory, when analysing organization-environment relationships (e.g., Baum&Singh, 1994; Lewin&Volberda, 1999; Cantwell et al., 2010). Indeed, the transaction cost theory posits that the larger the costs of using the market are (e.g., due to institutional gaps), the more internalisation will prevail with ownership structures that have a long-term interest in the host economy (Dunning, 2006; Dunning & Lundan, 2009).

At the most general level, foreign-invested enterprises will seek to steer institutional development towards a design that best serves their own commercial needs. Their decisions will depend on the incentives set by the existing institutions and the behaviour of the authority and other stake-holders. This is the essence of the IB-concept of co-evolution, in which both the foreign investor and the host economy drive the development of institutions by responding to the incentives created by their actions. For foreign investors, it may be rational to ensure that rules and regulations are developed in a way that allows them to extract the most profit from the host country, without regard to any implied negative effects on the host country. Similarly, it may be rational for foreign investors to support the development of the host location if this increases the profitability of the investment, following the IB concept of “local competence-creating efforts” (see, e.g., Cantwell, 2014, chapter 9).

From the perspective of the host country, it is beneficial if foreign-invested enterprises are profitable, so the authority will partner with foreign investors to design institutions. This, however, comes with the side condition of possible civil society activities to fight against negative implications of economic activity of foreign investors: the less an “exit” strategy (Hirschman, 1970) is viable for the host country’s citizens (see risks of outward migration from developing countries), the more will “voice” be used, leading to growing civil discontent and eventually civil unrest (In instances where outward migration is a viable option, the potential short-term consequences of de-escalation are soon outweighed by the adverse effects of brain drain).

The conditions under which foreign direct investors use their potential influence to engage in the co-evolution of development-friendly institutions thus depend on four key determinants: two of these originate from the incentives that foreign investors find in their host countries and abroad, while the other two are shaped by the degree of importance that host authorities ascribe to the aforementioned side-condition.

INSTITUTION-BUILDING AND THE ROLE OF INTERNATIONAL BUSINESS

FIEs Can Be Dominant and Hurt the Host Economy

Foreign-invested enterprises, like any economic venture, follow their overarching motive of economic survival on competitive markets. Profitability and the ability to increase shareholders’ value secures survival and constitutes the criteria of an enterprise to stand above its competitors. What puts them apart from other non-internationalised firms is their foreignness. Foreign investors with an international, often even global reach, possess experience from operating in a variety of different locations, each with different levels of quality of institutions. It is this experience that allows them to reap the benefits of operating in international markets, i.e., how to access external markets, how to procure internationally, and how to design strategies that utilize and consider opportunities provided by internationalization of activities. FDI tend to command significant market power, which allows them to cover the additional costs of being invested internationally (Hymer, 1960). They have better access to finance, they command a superior reputation for human resource management (even if only that they typically pay higher wages), they have more experience in using global markets, they often even have more political clout to negotiate with all levels of government for anything which may result in benefits, implicit (like e.g. regulations) and explicit (like e.g. subsidies or infrastructure investments). Investors who originate from highly developed countries and engage in developing countries also possess superior knowledge & technology relevant to efficient business operations.

All this grants them a competitive head start over domestic firms and allows them to dominate domestic markets, for example, by driving competitors in the host economy out of the market, by acquiring them, or by preventing the market entry of new competitors. In addition to these potential business-stealing, human capital-stealing, and crowding-out effects, it may be rational for foreign investors to reduce the costs of, for example, labour or the natural environment as factors of production. If additional profits from reducing unit labour costs below what can be ethically accepted, if profits from using the environment and land in an unsustainable manner are higher than the costs and risks discussed above, will foreign investors be rational in deciding against sustainable conduct and eventually dis-invest when the resources they were using are depleted, when their social credit is used up. Even in such a bleak latter scenario, foreign investors may be able to maximise their profits and shareholder value. There are many examples of investments turning into a burden for host countries, in most cases, paralleled by weak host country institutions: see e.g. the allegation that Chinese investments in the framework of the Belt and Road initiative tended to seek locations with weak institutional structures to be able to impose their own standards on the host country (Sutherland et al. 2020 and Brautigam 2009, for a less critical opinion).

With regard to labour costs, foreign investments may actively or implicitly restrict the local host economy from engaging in low-value-added production (screwdriver industries, outward processing trade; see e.g., Andreff & Andreff, 2001) – thereby locking it into some form of technological lock-in (Foxon, 2014). Important to note, however, that at a macro-level, specialisation on comparative advantages may—at least in the long run —adjust relative prices so as to allow economic development even for locked-in countries. For another explanation of a possible break-out of a technological trajectory, see Dolfsma&Leydesdorff, 2009). Such exploitation of national wealth (land grabbing, cheap labour, environmental pollution) allocates the benefits of investments nearly completely to the foreign investor whereas the host economy suffers.

FIEs can Help Host Economy by Transferring Technology – But This Depends on the Quality of Institutions

On the other hand, endogenous growth theory predicts that FDI will generate positive effects on productivity and economic growth in its host economies (Grossman & Helpman, 1991; Liu, 2008). The analysis of inward and outward FDI discusses several mechanisms through which the operations of foreign investment benefit the host economy, particularly through technological catch-up development. This may be driven by technology transfer and knowledge spillovers (see e.g., Stephan, 2013, chapters 4, 5 and 6) and in all cases, it is the quality of institutions in the host country that decide about how much of the potential benefit can materialise (see, e.g. ibid., chapter 7, on the institution of intellectual property rights).

Institutional Theory: Transaction Costs

Institutional theory suggests that foreignness may not only bring positive competitive effects; internationalized firms face higher transaction costs when operating in foreign markets where institutions are weak (see Jude & Levieuge, 2017, for an application to FDI). Just as the motive of foreign firms to internationalise can be based on Dunning's internalisation benefits, the instrument of internalisation can be used to overcome market transaction costs when the host market fails due to weak institutions (Feinberg & Gupta, 2009). We identify three groups of costs that arise from weak institutional frameworks in host countries:

(i) costs involved with the legal aspects of administrative procedures where norms are not entirely clear or enforced, where compliance is low, or where parallel structures exist (e.g., black markets, piracy, corruption, etc.); and
(ii) costs arising from the incompatibility of the foreign company's operations with the values of local stakeholders, with some potential for conflict and the resulting risks, including access to markets and resources, and their mitigation strategies; and
(iii) traditional transaction costs associated with using a market that is poorly supported by institutions (market failure, Williamson's transaction cost theory, see Jude and Levieuge, 2017, for an application to FDI).

Furthermore, foreign-invested enterprises are initially perceived as foreign entities by the local business community, particularly during their initial stages of establishment. In addition, they lack both local knowledge and the ability to interact effectively with local stakeholders, who may hold discriminatory attitudes towards them (Zaheer, 2017). Their ‘liability of foreignness’ requires them to consider their reputation and what is deemed to be ethical behaviour in their host societies (Denk et al., 2012). A foreign investment accused of wrongdoing in the host economy risks losing access to local resources and ultimately its business opportunities (Vanclay & Hanna, 2019). This issue of social license (Wilburn & Wilburn, 2011; Ho et al., 2024) is particularly sensitive in the case of foreign investment in the extractive industry and especially in mining, where external effects on the environment are particularly difficult and costly to prevent (Heffron et al., 2021; Fraser et al., 2021). Neglect of such criteria may result in additional costs, reducing profits and shareholder’s values. Paired with a weak institutional framework, such neglect can give rise to legal and regulatory uncertainties, which constitute operational risks.

Without social license, foreign firms in a weak institutional environment may end up operating in what is often termed an isolated “enclave” (see e.g., Higgins, 1956; based on Boeke’s dualistic theory, and more recently with a view on extractive industries: Narula, 2018): missing linkages will reduce the potentials for technology transfer and spillovers, in particular so where domestic firms suffer from inadequate absorptive capabilities for alien technology and where technological co-operation would allow foreign invested firms to benefit from a developing host economy business community (Cantwell, 2010). Missing linkages will additionally reduce the potential of participation in an effective and efficient innovation system, in which local research institutes, universities, and technology partners cooperate, and that is subsequently able to drive technological economic growth in the host economy (for an application to resource industries, see Fagerberg et al., 2009). In fact, transaction cost theory predicts exactly this outcome: the higher the costs of using the market, and these costs rise as the quality of institutions declines, the greater the motivation to internalise by using one’s own resources and capabilities rather than those of the host economy (see Feinberg & Gupta, 2009, for the case of weak institutions). A counter-strategy targeting alleged, assumed, or real existing sources of social distrust or outright rejection of foreign firms can focus on increasing local embeddedness (Iurkov & Benito, 2018), thereby solidifying the social license to operate in the host country.

Another motive that we can identify in relation to the values carried by stakeholders (such as governments, regulators, employees, customers, competitors, and other members of the local business community and civil society) pertains to the foreign investor’s reputation and brand image. What at first glance looks like a marketing mechanism (and with respect to the environmental footprint is often labelled ‘greenwashing’), becomes much more profound in the case of FDIs in developing countries: admittedly, consumers in home countries and other highly developed countries on average attach little weight on the human rights and environmental protection records in other countries. Reputation and brand image are more determined by fashion and the usefulness of the product or service produced externally. Empirically, however, we observe that foreign investors increasingly consider their local reputation and brand image to be relevant, as local stakeholders in less developed host countries increasingly take a critical view on the conduct of foreign investors in their economies (see e.g., Disdier & Marette, 2012). Host civil society increasingly demands that foreign firms respect the rights of indigenous people, invest in social development projects, and the like – in short that they demonstrate corporate social responsibility (CSR), ethical behaviour and commitment to the goals of sustainable development (Fallah Shayan et al., 2022; López-Concepción et al., 2022). A positive conduct by foreign-invested enterprises can hence improve reputation and brand image in the host country by increasing stakeholder’s trust and willingness to co-operate with the foreign invested firm. This can even be used to differentiate a foreign investor positively from competitors who fail to consider this aspect.

Motivation for Co-Evolution

The cost-centred and the institutional analysis show that foreign investors have a strong rational motivation to engage in activities that support the development of inclusive institutions in host countries. And they tend to have the necessary institutional capacity and resources to make the most of non-financial reporting instruments, such as CSR or the SDG agenda (Bose & Khsan, 2022, p. 2). Investments in

institutional development in the host country can help mitigate costs and risks by promoting regulatory transparency, which enhances legal protection when firms comply (Cantwell et al., 2010) and increases social license through embeddedness in the local host business community. By aligning institutions of their host country with those of the investor's international network, foreign investors reduce costly and risky incompatibilities in norms (Jepperson, 1991; Seo&Creed, 2002; Zilber, 2007); possibly also values (Thornton et al., 2012). This attempt to harmonize is particularly strong where home-country rules require foreign investors to adhere to stricter home-country institutions, even outside home-country jurisdiction. By transferring their home country management techniques and organisational norms, by adhering to home-country standards of corporate governance, transparency, and accountability, foreign investors are more likely to promote the emergence of institutions in the host country that are robust, transparent, and accountable, i.e., move closer to what Acemoglu&Robinson (2012) call "inclusive institutions". In this way, foreign investors create a favourable business environment that enhances their long-term viability and profitability in the host country. It is particularly important to note that such activity is not driven by a direct attempt to maximise profits, but rather the ultimate objective is furthered indirectly.

In light of the aforementioned, the narrative exhibits an interesting twist of non-linearity: where the host country has a very low quality of institutions, foreign investors may find it preferable to ignore local stakeholders and operate in enclaves (and in the case of China, sometimes even protected by their own security staff). Only where the institutional gap is lower will institutional co-evolution promise to bear more fruits than exploitation. The set of motivations hence can go both ways and the decision of where the dynamics of institutional development will tend to depends on the starting level of institutional quality. Two diametrically opposed outcomes can occur. The most important condition for foreign direct investors to participate in the development of institutions is the quality of the institutions they are confronted with at the outset of their investments.

Predicted Motives of Host Country Authority

The same applies to the motivations of the local host authority: the lower the quality of institutions, the more profitable is an extraction strategy in which members of the local, regional and central administration and government are able to pocket individual benefits granted by foreign investors for any kind of assistance. This then constitutes corrupt behaviour, and the reason why it must to be condemned from all perspectives is that such assistance to foreign investors has a detrimental impact on the host country. Such assistance may have the effect of tilting the level playing field against other enterprises and investors, resulting in associated distortions of the allocation of scarce resources. Alternatively, it may place a burden on other entities, resulting in adverse effects such as land grabbing and environmental damage. Corruption has ramifications that extend beyond the purely economic sphere. For example, it can reinforce the authority of politicians, providing a source of legitimacy that is based on policies aimed at fostering national development.

THE ROLE OF EXTERNAL GOVERNING INSTITUTIONS

What entity is in the position to deploy both the requisite power and the incentive to contribute to facilitating the establishment of development-friendly, inclusive institutions in less developed countries? What system is capable of ensuring the adherence of investors, both in general and foreign direct investors in particular, to sustainable and ethically responsible conduct?

The concept of transnational advocacy networks as part of civil society comes into play and includes non-governmental organisations (NGOs), multilateral and bilateral organisations and agreements as well as a multitude of specialised advocacy groups that work to promote awareness, influence policies and bring about change in varied areas of concern (Osegowitsch et al., 2022), like e.g., environmental organizations (WWF; Greenpeace; etc.), human rights groups (Amnesty International; Human Rights Watch; etc.), consumers rights groups (Consumer Reports; Public Citizen; etc.), and healthcare advocacy groups (Médecins Sans Frontières; Partners In Health; etc.). Positive engagement in such institutions can help firms to differentiate themselves from competitors and strengthen brand loyalty. Moreover, such groups help

extend firms' networks: by collaborating with NGOs, advocacy groups, and civil society organizations involved in transnational advocacy networks, firms can gain insights into emerging trends, consumer preferences, and regulatory developments related to human rights, environmental protection, and corporate governance. This access to information and networks can help firms identify market opportunities, innovate new products and services, and expand their customer base in alignment with sustainable development goals.

While these groups do command some political clout to advocate for institutional reform and regulatory transparency, they lack the legislative power to effectively enforce those goals. Neither do consumers, stakeholders, or even shareholders, where they are broadly dispersed, command such powers. Neither do consumers command legal enforcement rights. Consumers have some power by rejecting the products of non-compliant producers. So far, very little has been observed in that respect. Shareholders are actually entrusted with enforcement rights through their ownership of shares. Where FDIs are stock-listed companies, the dispersion of stocks is typically too wide for individuals to make a significant change. Cartels of owners are difficult to organise, because of the short-term nature of portfolio investments.

It is the foreign investors who decide whether the long-term benefits of compliance to some form of responsible conduct exceed the costs of reverting to pure short-term efficiency-guided policies today. Markets (governing the decisions of firms) are often too short-sighted to have sufficient incentive to contribute their share towards the generation of development-friendly institutions. The risk of significant adverse effects on reputation and with it a loss in profits due to human rights abuses, environmental controversies, or ethical lapses in foreign and often far away production locations had in the past typically been too low to effectively prevent such ill-doing: strategies of blurring information about particular cases proved to be working well (see e.g. the example of German Volkswagen's investment in China and the allegation related to Uyghur forced labour). We find a large list of foreign investors who claim to consider the needs of the host economy, environment, and local communities, and yet, we observe rather rare cases, where firms aligned their business models and organisational cultures sufficiently to make a real difference in terms of protection of human rights, environmental sustainability, and corporate accountability (see e.g. UN, 2019 and 2021).

Where foreign investors do not opt for benign institutional co-development, because institutions are still insufficiently robust, the only remaining option is to install another external power. This brings the foreign investor's home regulators and governments into play: they are the only actors able to ensure that private foreign involvement in weak institutions host countries is beneficial for the host country. Empirical evidence from the relevant literature shows that it is the regulations enacted and enforced by home countries that prove more effective than those of host countries (e.g., Kolk & Fortanier, 2013, pp. 92-3).

Will home country legislators actually go so far as to tie the hands of their foreign investors? Recent legislative moves point in this direction: the EU's Act on Corporate Due Diligence Obligations in Supply Chains and the US Supply Chain Due Diligence Act (and many related laws and regulations) enacted in the last few years are cases in point: they all focus on complete value chains, which today are often international. The political controversy naturally revolves around the issue of holding companies (and in the US their managers) accountable for the actions of their suppliers in other countries, even if those suppliers are outside their jurisdiction (and not even necessarily linked to the home firm by ownership). These recent developments raise the hope that wealthy investor countries will excel in assuming their responsibilities and enforcing norms for their own investors' behavior outside their own jurisdictions, and will begin to sanction misbehavior in their own courts (see, e.g., the recent decision by a Dutch court on Shell's investment in Nigeria).

What remains open is under what conditions home countries are motivated to attach strings to their own firms when they invest in developing countries. This, in turn, is a political aspect outside the realm of economic analysis. Needless to say, that the propensity to agree on common minimum standards in environmental protection and business ethics is highest in a world where multilateralism is thriving: where blocks of countries compete with diverging objectives and values on issues such as human rights, environmental sustainability, and corporate accountability, home countries will rationally shy away from attaching more strings to their own firms when investing abroad. The likely result is then either an outright

race-to-the-bottom to the detriment of the least developed countries with weak institutions or global trade falling into blocks, in which hopefully block members are willing to consider environmental and ethical aspects.

CONCLUSIONS

The impact of foreign direct investment on institution-building in developing countries often turns out to be either negative or positive. Its impact depends on a number of factors, including the specific characteristics of the investment and the context in which it takes place. This encompasses considerations such as the balance between potential benefits (including increased profits and shareholder value derived from windfall profits and rent-seeking opportunities) and costs associated with the legal aspects, the impact of stakeholders' preferences and valuation of the investment and operations, and transaction costs. Additionally, the investment strategy pursued by the foreign-invested enterprise plays a crucial role in shaping the outcomes of FDI institutional co-evolution. Amongst the most important, however, is the quality of institutions existing when foreign investment takes place: FDI into developing countries with very weak institutional frameworks, the host country does not command sufficient legislative and political/regulatory clout to make sure the investment will contribute to SGDs. The presence of a dominant foreign-invested enterprise may result in the exploitation of the host country's resources, including natural resources, land, human capital, and the environment, in an unsustainable manner. This occurs when the foreign investor prioritizes maximizing profits and shareholder value without sufficient concern for SDGs.

This is particularly pertinent for investments where potential windfall profits are sizable, as in natural resource industries with their mining, refining, and processing operations. In the case of state-corruption, there is an unholy alliance between regulatory bodies and foreign investors, exacerbating the challenges and risks associated with such investments.

Only for the development of industry, innovation, and infrastructure (SDG 9) can we expect a match between some investors' strategies (Cantwell) and the needs of developing countries. Institutional economic development theory not only identifies the crucial institutions necessary to improve economic development prospects but also elucidates the mechanisms that determine the balance between the motivations of stakeholders committed to advancing SDGs and those neglecting conditions essential for qualitative development. Particularly within natural resource industries in less developed countries, the pivotal role of institutions becomes pronounced in the endeavor to transition from the resource curse to a developmental boon.

It is not always the case that positive effects will manifest through market mechanisms. In fact, they may only emerge when there is some form of external pressure, or in market terms: costs and norms. This pressure can originate from within the industry itself, from consumers, from shareholders, from stakeholders, but the market motivations are often weak: (i) firms investing in host countries with weak institutions may adopt such responsibilities as a marketing and branding device, or indeed may decide that this can be an efficient behaviour given expectations on the demand side or other stakeholders; (ii) firms may comply with standards enforced by (global) value chains (this includes pressure by financial markets); and (iii) foreign investors may be bound by rules and regulations in their host countries.

The analysis of development theories and international business theories, along with empirical evidence, suggests that the only real power to ensure the co-evolution of inclusive institutions in host countries can be expected to emanate from outside the host country. This assigns the responsibility to regulators in foreign investors' home countries. Alongside the assistance provided by transnational advocacy groups, the ultimate responsibility lies with the legislative and enforcement powers of home countries. Recent trends indicate a growing motivation to fulfil such responsibilities, largely propelled by political pressure from consumers in home countries. Despite the enactment of some norms many decades ago, they have not proven entirely effective in preventing ongoing abuses against citizens, the environment, natural resources, and industries in some developing countries. While progress has been made in achieving a better balance, current efforts may still fall short in addressing the breadth of sanctioned behaviour, while simultaneously placing excessive responsibility and accountability on foreign investors. For instance, in

some regions, corruption remains deeply ingrained in daily business practices, to the extent that refraining from such activities could hinder business opportunities. Additionally, operating in countries where corruption is prevalent can compromise competitiveness if other home countries do not enforce comparable norms. Only time will reveal the trajectory of globalization; however, greater multilateralism offers promise for less and least developed countries in striking the right balance for inward FDI.

The final outstanding question concerns the circumstances under which home countries are motivated to impose conditions on their own firms when they invest in developing countries. This is a political matter that lies beyond the scope of economic analysis. It is evident, though, that in a scenario, where countries compete for investment with their own diverging objectives and values, home countries will rationally shy away from attaching more strings to their own firms when investing abroad. The probable outcome is either a race to the bottom in terms of institutional quality or the fragmentation of global trade into blocs with their own coherent sets of norms and standards. The probability of consensus on shared (even if merely minimal) standards in environmental protection, human rights, and business ethics is greatest in a global environment where multilateralism is flourishing.

In the end, all three determinants of the conditions under which foreign direct investors use their potential influence to engage in the co-evolution of development-friendly institutions boil down to one common criterion: the quality if institutions that foreign investors are confronted with when investing: institutions determined by their host countries and institutions that their home countries subject them to. Where institutions are sufficiently developed, the benign effects of inward FDI on institutional co-evolution will prevail; where institutions are too weak, foreign investors will partner with the host authority to earn income through corruption and windfall profits, while neglecting externalities to its citizens.

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