Handbook on Policies, Promotion and Facilitation of Foreign Direct Investment for Sustainable Development In Asia and the Pacific

UNITED NATIONS ESCAP
Economic and Social Commission for Asia and the Pacific

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HANDBOOK ON POLICIES, PROMOTION AND FACILITATION OF FOREIGN DIRECT INVESTMENT FOR SUSTAINABLE DEVELOPMENT IN ASIA AND THE PACIFIC

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FOREWORD

Foreign Direct Investment (FDI) makes a vital contribution to growth and development in Asia and the Pacific. In recent years, the region has attracted up to half of annual total global inflows. It continues to outperform the global average and, although from a low base, FDI to our least developed countries has trebled since 2005. Greenfield FDI into our region increased by 12% in 2016 to some $395 billion. New jobs linked to greenfield FDI rose by 9%.

The valuable role of FDI as an external source of financing for development is well established. It has been recognized by the Addis Ababa Action Agenda as a central means of implementation for the 2030 Agenda for Sustainable Development. But while countries in the Asia-Pacific have been working actively to attract as much FDI as possible, the overall positive picture for our region belies big differences in individual nations' ability to attract investment and ensure it delivers sustainable benefits. At the same time, the dynamics of investment flows are changing. Several emerging economies in our region have themselves become major sources of FDI while outflows from developed countries have declined.

Against the backdrop of these changing dynamics, this Handbook reviews the current research on FDI and considers relevant experiences in our region and beyond. Its goal is to identify best practices and formulate concrete recommendations for policies to promote and facilitate FDI which supports economic, social and environmental sustainable development. The Handbook demonstrates the complex and interrelated nature of the issues to which effective policies should respond. It aims to present them clearly and comprehensively as a reference for policymakers and investment promotion agencies working to develop and implement effective FDI policies.

The academic literature on FDI has evolved significantly as the nature of FDI has changed and as the global economy has become more integrated. The Handbook not only summarizes existing knowledge on FDI, but also presents approaches which have worked effectively to attract it and then ensure its benefits are delivered at the national, subnational and regional level. If we are to deliver sustainable growth in line with the 2030 Agenda Sustainable Development Goals, business as usual on this front is no longer an option. The role of business and government at all levels needs to change to meet sustainability requirements.

This Handbook collects and summarizes the findings and recommendations of global and regional experts and institutions which have been active in shaping thinking on these issues, including the Columbia Center on Sustainable Investment, OECD, UNCTAD and the World Bank Group. I hope this Handbook will serve as the solid analysis which is needed to exploit FDI's full potential as we work to support growth and development across Asia and the Pacific.

Shamshad Akhtar
Under-Secretary-General of the United Nations and
Executive Secretary of ESCAP

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ABBREVIATIONS AND ACRONYMS

ACIA	ASEAN Comprehensive Investment Agreement
ADB	Asian Development Bank
AEC	ASEAN Economic Community
AFTA	ASEAN Free Trade Area
AIA	ASEAN Investment Area
APTA	Asia-Pacific Trade Agreement
ASEAN	Association of South-East Asian Nations
BEPS	base erosion and profit shifting
BMD	Benchmark Definition of Foreign Direct Investment (OECD)
BoP	balance of payments
BPM	Balance of Payments and International Investment Position Manual (IMF)
BIT	bilateral investment treaty
CBA	cost-benefit analysis
CIT	corporate income tax
CRM	customer relations management
CSR	corporate social responsibility
DTT	double taxation treaty
EDO	economic development organization
EPA	economic partnerships agreements
ESG	environmental, social and governance
EPZ	export processing zone
FDI	foreign direct investment
FET	fair and equitable treatment
FIAS	Facility for Investment Climate Advisory Services (World Bank)
FPI	foreign portfolio investment
FTA	free trade agreement
GATS	General Agreement on Trade in Services
GIPB	global investment promotion best practice
GIS	geographical information system
GMS	Greater Mekong Subregion
GRI	Global Reporting Initiative
GVC	global value chain
IADB	Inter-American Development Bank
ICC	International Chamber of Commerce
ICSID	International Centre for Settlement of Investment Disputes
IIA	international investment agreement

ILO	International Labour Organization
IMF	International Monetary Fund
IPA	investment promotion agency
IPFSD	Investment Policy Framework for Sustainable Development (UNCTAD)
IPP	investment project proposal
IPR	intellectual property rights
ISC	investment services centre
ISDS	investor-state dispute settlement
ITC	International Trade Centre
ISO	International Organization for Standardization
ICT	information and communications technology
IT	information technology
JV	joint venture
KPI	key performance indicators
LDC	least developed country
LVP	location value proposition
MAI	Multilateral Agreement on Investment
MFI	multilateral framework for investment
M&A	mergers and acquisitions
MDG	Millennium Development Goal
MFN	most-favoured-nation
MNC	multinational corporation
MNE	multinational enterprise
NGO	non-governmental organization
NIS	national innovation system
NT	national treatment
ODA	official development assistance
OECD	Organisation for Economic Co-operation and Development
OLI	ownership, location, internalize
OSCE	Organization for Security and Co-operation in Europe
OSS	one-stop shop
PTA	preferential trade agreement
RBC	responsible business conduct
RCEP	Regional Comprehensive Economic Partnership
R&D	research and development
RIA	regional integration agreement
RMG	ready-made garments
RTA	regional trade agreement
SDG	Sustainable Development Goal
SCM	subsidies and countervailing measures
SEZ	special economic zone
SME	small and medium-sized enterprise
SOE	state-owned enterprise

SSDS	state-to-state dispute settlement
SWF	sovereign wealth funds
TIP	treaty with investment provisions
TNC	transnational corporation
TPP	Trans-Pacific Partnership Agreement
TRIMS	trade-related investment measures
TRIPS	trade-related intellectual property rights
UIC	ultimate investing country
UNCITRAL	United Nations Commission on International Trade Law
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
WAIPA	World Association of Investment Promotion Agencies
WCO	World Customs Organization
WTO	World Trade Organization

INTRODUCTION

Once maligned as a neo-colonialist tool of Western countries to dominate and exploit developing countries, foreign direct investment (FDI) has become an essential source of finance, technology and expertise for many of them to the extent that competition to attract FDI has led to diminishing returns and benefits from FDI. With ever dwindling financial flows from official development assistance (ODA) and private bank lending in the wake of the massive debt crisis, FDI has become the most important source of private external financing for development, accounting for around 60% of total external capital inflows into developing countries.[1] After the 1997/1998 Asian Financial Crisis, even those countries in the Asia-Pacific that had not relied on FDI before were forced to open up as part of the International Monetary Fund (IMF) bail-out packages and have since then increasingly relied on FDI as an important source of capital. However, the 2008 Global Economic Crisis has put a severe dent on both FDI flows and exports. While trade is expected to remain stagnant in the next few years, there may be more hope for a revival of FDI.

The importance of FDI as a source of external financing for development was recognized in the 2002 Monterrey Consensus on Financing for Development and its successor, the 2015 Addis Ababa Action Agenda on Financing for Development. It takes prominent place as means of implementation in the 2030 Agenda for Sustainable Development which includes the Sustainable Development Goals (SDGs), replacing the Millennium Development Goals (MDGs). Indeed, the importance of FDI is recognized in many other international platforms and action plans, including those for least developed countries (LDCs) and countries with economies in transition.

The importance of FDI as a source of private capital is underscored by the enormous financing needs of developing countries which is unlikely to be met by public revenue and ODA alone. According to the United Nations Conference on Trade and Development (UNCTAD), estimates for total investment needs in developing countries alone range from $3.3 trillion to $4.5 trillion per year, for basic infrastructure (roads, rail and ports; power stations; water and sanitation), food security (agriculture and rural development), climate change mitigation and adaptation, health, and education. At today's level of investment – public and private – in SDG-related sectors in developing countries, an average annual funding shortfall over 2015-2030 of some $2.5 trillion remains.[2] With respect to infrastructure alone in Asia and the Pacific, a 2009 Asian Development Bank (ADB) report projected that total investment needs for four infrastructure sectors (i.e. transport, power, telecommunications, and water supply and sanitation) would be slightly above $8 trillion (in 2008 prices) for the 11-year period 2010-2020, or almost $750 billion a year.[3] The most recent ADB estimates include the costs of climate mitigation and adaptation (climate-adjusted estimate) for developing Asia amounting to $26 trillion over the 15-years from 2016 to 2030, or $1.7 trillion per year. Without climate-adjusted costs (baseline estimate), the required infrastructure investment would amount to $22.6 trillion, or $1.5 trillion per year.[4]

Therefore, it appears that FDI has moved from "villain" to "saviour". For that purpose, countries have actively pursued the attraction of FDI, often through specialized institutions known as investment promotion agencies (IPAs) or economic development organizations (EDOs).[5] They have also increasingly used financial incentives as a carrot to compensate for lacking investment climates and engaged in fierce competition for FDI, which has sometimes led to a race to the bottom and undermined development benefits from FDI which remain essentially financial. At the same time, the track record of FDI benefits remains mixed and concerns remain as to the actual contributions of FDI to development, particularly with regard to the sustainability of that development.

Some countries have clearly managed to attract FDI better than others for various reasons. Some have actively promoted outward FDI to enhance the global competitiveness of their enterprises. Most countries have benefited from FDI. However, others have either failed to attract sufficient FDI flows in both quantitative and

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1 Available from: **https://www.oecd.org/dac/Post%202015%20Investment%20for%20sustainable%20development.pdf.**

2 UNCTAD, *World Investment Report 2014: Investing in the SDGs, an action plan* (United Nations publication, Sales No. E.14.II.D). Available from: **http://unctad.org/en/PublicationsLibrary/wir2014_en.pdf.**

3 ADB and Asian Development Bank Institute, *Infrastructure for a Seamless Asia* (Manila, 2009). Available from: **https://www.adb.org/sites/default/files/publication/159348/adbi-infrastructure-seamless-asia.pdf.**

4 ADB, *Meeting Asia's Infrastructure Needs* (Manila, 2017). Available from: **https://www.adb.org/sites/default/files/publication/227496/special-report-infrastructure.pdf.**

5 The term IPA is used in Asia and the Pacific while the use of "economic development organizations" is more common in North America. In this Handbook, only the term IPA is used with the understanding that all references to IPAs are meant to include those organizations also.

qualitative terms or failed to benefit from such inflows. This is particularly true for the LDCs and other disadvantaged developing countries. While FDI is recognized principally as an external source of finance capital, issues related to the sustainability and contribution of FDI as a means of implementation of the SDGs have become more prominent. In other words, the mere attraction of FDI does not necessarily imply development benefits. And where development benefits are derived, they may be only economic at the cost of the environmental and social dimensions of sustainable development.

In recent decades, the nature, composition and sources of FDI have clearly changed and become more complicated. FDI has become both a cause and result of globalization. In particular, FDI has led to the rise and expansion of regional and global value chains (GVCs), which have generated employment and helped small and medium-sized enterprises (SMEs) develop and flourish as subcontractors and suppliers of parts and components and service providers in many cases in selected sectors helped by conducive policies. FDI has triggered the expansion of regional and bilateral trade agreements while such agreements, in turn, have increasingly incorporated investment chapters, helping FDI. Increasingly, FDI is no longer exclusively flowing from rich developed countries but increasingly from emerging developing countries. In this context, the rise of China is particularly noteworthy and FDI flows among developing countries have become prominent. However, GVCs have also led to an obfuscation of actual sources of FDI and nationality of the principal agents of FDI, the transnational corporation (TNC), while the global nature of TNCs have helped them to avoid and evade taxation, again undermining the potential of FDI as an important source of external financing for development. In the absence of a global legal regime for FDI, concerns with the lack of responsible business practices (RBC) of TNCs has risen and grown with a shifting emphasis towards sustainability issues.

The issues related to inward FDI and its relationship with development are many and of varying complexity. In this regard, much has already been written about these issues. The academic literature is rife with articles on the determinants and impact of inward FDI, recommendations on how to improve the investment climate and adopt and implement policies that ensure higher inflows of FDI. Currently, the emphasis has shifted towards policies that ensure a positive contribution of FDI to sustainable development. The most prominent publication on FDI for many years has been the annual UNCTAD World Investment Report.

This Handbook seeks to take stock of the findings on and experiences with inward FDI and to summarize them in a convenient package that helps policymakers formulate better FDI policies and IPAs to better promote and facilitate FDI for sustainable development. Better FDI policies means policies that help attract higher inflows of FDI of higher quality and higher development impact across the three dimensions of sustainable development: economic, social and environmental. Better promotion and facilitation means the adoption and utilization of more effective, targeted and resource-efficient tools and instruments to attract foreign investors, and help them establish and realize their investment and subsequent operations. The institutions that formulate policies are ideally not the same institutions that promote and facilitate FDI. The formulation of FDI policies and FDI promotion and facilitation require different mind sets, approaches, skills and tools. However, obviously they are inextricably linked. Similarly, FDI policies and FDI legislation and regulations are also closely linked and one cannot be discussed without referring to the other.

For this purpose, and in light of the shifting demands on FDI as a means of implementation for achieving the SDGs, this Handbook seeks to put together recommendations for both policymaking, law making, and investment promotion and facilitation based on best and good practices derived from experiences with inward FDI worldwide. The Handbook will not present sweeping new insights or new revealing information. There is really no need to reinvent the wheel. However, it means to be a useful reference tool for policymakers, legislators and IPAs given the extensive literature on FDI that has accumulated over many years, summarizing and packaging the recommendations that have emanated from this literature and experiences with FDI attraction, promotion and facilitation both in Asia and the Pacific and in the world at large.

Chapter 1 acts as a useful introductory chapter discussing the fundamentals of FDI, i.e. definitions, types and forms and determinants. This chapter is therefore largely theoretical and conceptual and addresses the issue of sustainability and “sustainable” FDI.

Chapter 2 then looks at the trends in inward FDI over the last few decades and impacts on (sustainable) development, both for home and host countries of FDI, though clearly with emphasis on the latter, both positive and negative. A thorough understanding of the potential and actual impacts of FDI provides useful lessons for policies, laws and regulations.

Chapter 3 provides a thorough coverage of the recommended policy frameworks for inward FDI. This chapter is the largest of the Handbook. It deals with various policy objectives of FDI, including privatization, linkages, technology development and the sustainability aspects of FDI. It discussed the role of FDI in the context of wider economic liberalization and deregulation and the need to strengthen national competitive advantage. In other words, FDI policy needs to be seen in a wider context, i.e. economic policy or development policy and cannot be seen in isolation. The message is that FDI can really contribute to sustainable development in the right policy environment but that FDI by itself is no panacea for development and needs to be supported by other policies, in particular policies that improve the overall business and investment climate for both domestic and foreign enterprises and strengthen national competitive advantage. Reference is made to existing policy frameworks such as the Organisation for Economic Co-operationa and Development (OECD) Policy Framework for Investment and the UNCTAD Investment Policy Framework for Sustainable Development (IPFSD).

Chapter 4 looks at the required institutional and legal framework for FDI. The institutional framework refers to institutions required for policy formulation and implementation rather than for investment promotion which will be discussed in chapter 6. The chapter will discuss legal frameworks both at the national level and international level. At the national level, legal issues and requirements for FDI attraction and benefiting from it go beyond a mere focus on FDI but discuss the larger legal issues that have a direct and indirect impact on FDI flows. The international context of FDI refers to the concept of international investment agreements (IIAs) and their role in attracting FDI. Recommendations are provided on how such IIAs can be improved for developing countries to attract better FDI and benefit from it.

Chapter 5 looks at three important and popular modalities of FDI policy: incentives, performance requirements and special economic zones (SEZs). The track record of experiences with those three policy tools is very mixed and it is important that countries adopt such tools with caution and make them mutually consistent, coherent and complementary. Incentives can be waste of resources and rarely act as a major determinant for investors but can tilt one location over another as the favoured investment location decision of a foreign investor. Performance requirements are popular as an instrument for policymakers to enhance the contribution of FDI to development, but again the track record is mixed and in practice such requirements have often been counterproductive in attracting FDI and generating benefits for host countries. SEZs are a common feature in most developing countries and again, some have been more successful than others. The chapter looks at the success criteria for all three policy tools as a basis for policies that optimize the use of such tools and derive benefits from them.

Chapter 6 moves beyond investment policy towards investment promotion and starts with discussing the institutional requirements for effective investment promotion, i.e. the structure, set-up, management and monitoring and evaluation of the investment promotion agency (IPA) and its relation to other related institutions such as trade promotion offices and government ministries and agencies responsible for policymaking.

Chapter 7 discusses the tools and instruments for active and effective investment promotion. Clearly, such tools have developed over the years and have become increasingly digitalized with websites standing out as useful modalities for both investment promotion and facilitation. The chapter discusses the aspects of a good website and other tools for both investment promotion and the first stage towards investment promotion: image building. The chapter also promotes investor targeting as an important mechanism to use scarce resources of the IPA to optimum effect and the requirements for effective investor targeting.

Chapter 8 discusses the concept of investment facilitation, what it entails and what IPAs need to do to engage in effective investment facilitation and effectively deal with investor queries. It has become apparent that investment facilitation is growing in importance as attracted FDI may not necessarily result in realized FDI. As a result, IPAs increasingly focus on investment facilitation rather than investment promotion as it is understood that addressing the needs of existing investors is probably more important than attracting new investment, in particular as existing investors can act as ambassadors and effective investment promoters of a host locality in their respective home countries. When existing investors are not happy, the IPA is not likely to be able to attract new investors. In this context, the issue of aftercare is particularly important and refers to investment facilitation in the post-establishment phase of the investment cycle. This is a new area for many IPAs and therefore warrants special attention.

Each chapter ends with a summary of recommendations and questions for national level policymakers and IPAs to advance the discussion on the role of FDI in development and modalities to more effectively and efficiently attract, promote and facilitate FDI in the context of the global nature of FDI and TNCs and shifting national and international legal frameworks, trends and players.

The Handbook acts as source book for comprehensive training courses on FDI policy, promotion and facilitation that ESCAP offers to countries upon request. Increasingly, such courses are not only delivered in the capitals of countries but also at provincial and municipal level where investment facilitation matters probably the most. Countries are encouraged to submit formal request for assistance on FDI to ESCAP. Such assistance is available sometimes free of charge but, most commonly, only entail the costs of travel and daily subsistence allowance of two to three resource persons, depending on the duration of the training course which can vary from one day to two weeks.

It is hoped that this Handbook will be a useful resource for policymakers and IPAs alike and feedback on possible improvements or corrections are certainly welcomed for the second edition. Such feedback may kindly be addressed to: Director, Trade, Investment and Innovation Division, ESCAP, Bangkok 10200, Thailand; Tel: (66-2) 288-1410; Fax: (66-2) 288-1027, 288-3066; e-mail: escap-tiid@un.org.

CHAPTER ONE

1

FOREIGN DIRECT INVESTMENT FUNDAMENTALS

A. DEFINITIONS OF FOREIGN DIRECT INVESTMENT

The concept of **foreign direct investment** is widely used by economists and policymakers but its definition is not so straightforward. To properly understand the concept of FDI, it is important to distinguish it from the concept of foreign indirect investment or **foreign portfolio investment** (FPI). The difference between FDI and FPI is mostly associated with the concepts of ownership and control. FDI implies active management as it is controlled by the investor. FPI is solely occupied with the passive ownership of a firm, mostly through bonds, shares and equity stocks, and does not entail the active involvement, management or control of the investment (see box 1.1).

Box 1.1. FDI vs. FPI

FPI is much more volatile than FDI. Whereas FDI entails the investment in immovable property and assets, FPI is investment in financial securities which can easily be sold or traded unlike factories and machines. For a country on the rise, FPI can bring about rapid development, helping an emerging economy move quickly to take advantage of economic opportunity, creating many new jobs and significant wealth. However, when a country's economic situation takes a downturn, sometimes just by failing to meet the expectations of international investors, the large flow of money into a country can turn into a stampede away from it. When the United States Federal Reserve raises its interest rates, for instance, it can quickly draw capital away from emerging markets.

Certain elements of FDI include:

- **Cross-border** investment;
- Objective of establishing a **lasting interest** in an enterprise that is resident in an economy other than that of the investor;
- Lasting interest that is defined as at having at least **10% of the voting power** of the invested enterprise;
    - **Subsidiaries** are direct investment enterprises of which 50% or more of the voting power is held by the direct investor;
    - **Associates** or **affiliates** are direct investment enterprises of which 10-50% of the voting power is held by the direct investor; and
    - **Branches** are direct investment enterprises of which 100% of the voting power is held by the direct investor.

The investing enterprise usually has a presence in multiple countries and is therefore commonly known as a multinational enterprise (MNE), multinational corporation (MNC) or a transnational corporation (TNC). As soon as a domestic enterprise engages in FDI in another country it is termed as such. In this Handbook, the established United Nations terminology of TNC is used.

Various definitions of FDI have been in circulation. One objective of the current round of revisions to the sixth edition of the IMF) *Balance of Payments and International Investment Position Manual* (BPM6) and the fourth edition of the OECD *Benchmark Definition of Foreign Direct Investment* (BMD4) is to maintain and strengthen the harmonization of FDI definitions used.

According to BPM6, "direct investment is a category of cross-border investment associated with a resident in one economy having control or a significant degree of influence on the management of an enterprise that is resident in another economy". In other words, FDI refers to an investment made to acquire lasting interest in enterprises operating outside of the economy of the investor. Further, in cases of FDI, the investor's purpose is to gain an effective voice in the management of the enterprise. The foreign entity or group of associated entities that makes the investment is termed the "direct investor". The unincorporated or incorporated enterprise in which direct investment is made is referred to as a **"direct investment enterprise".** Some degree of equity ownership is almost always considered to be associated with an effective voice in the management of an enterprise; the BPM6 suggests a threshold of 10% of equity ownership to qualify an investor as a foreign direct investor.

In particular, BPM6 states that control or influence may be achieved directly by owning equity that gives voting power in the enterprise, or indirectly by having voting power in another enterprise that has voting power in the enterprise. Accordingly, two ways of having control or influence are identified:

(1) **Immediate direct investment relationships** arise when a direct investor directly owns equity that entitles it to 10% or more of the voting power in the direct investment enterprise. Control is determined to exist if the direct investor owns more than 50% of the voting power in the direct investment enterprise. A significant degree of influence is determined to exist if the direct investor owns from 10 to 50% of the voting power in the direct investment enterprise.

(2) **Indirect direct investment relationships** arise through the ownership of voting power in one direct investment enterprise that owns voting power in another enterprise or enterprises, that is, an entity can exercise indirect control or influence through a chain of direct investment relationships.

While these definitions are still valid, it becomes increasingly difficult to determine the ownership of a particular affiliate or subsidiary of a TNC in any given host country. This has implications for FDI policy and laws and regulations, including bilateral investment treaties and other international investment agreements host countries of FDI are party to (UNCTAD, 2016). Box 1.2 explains this further.

Box 1.2. Blurring ownership of foreign affiliates

Investor nationality is blurring as a result of complex TNC ownership structures. This has important investment policy implications, because most countries have rules and regulations that distinguish between domestic and foreign investors, and because international investment agreements (IIAs) provide benefits to investors based on their origin. UNCTAD World Investment Report 2016 notes that more than 40% of foreign affiliates worldwide have multiple "passports". These affiliates are part of complex ownership chains with multiple cross-border links involving on average three jurisdictions. These types of affiliates are much more common in the largest TNCs: 60% of their foreign affiliates have multiple cross-border ownership links to the parent company. The nationality of investors in and owners of foreign affiliates is becoming increasingly blurred.

"Multiple passport affiliates" are the result of indirect foreign ownership, transit investment through third countries, and round-tripping (see box 1.3). About 30% of foreign affiliates are indirectly foreign owned through a domestic entity; more than 10% are owned through an intermediate entity in a third country; about 1% is ultimately owned by a domestic entity. These "investor nationality mismatch" cases involve almost half of foreign affiliates in developed economies, and more than a quarter in developing economies.

The issue of determining nationality is of importance in investment disputes too and for TNCs seeking diplomatic protection from their "home" countries. Under international law, one of the key requirements for claiming diplomatic protection is the existence of an "effective bond" of nationality or "genuine connection" between the TNC (investor) and the state which makes the claim on behalf of the investor. So what constitutes this "effective bond" of nationality or "genuine connection"?

While no absolute text of a "genuine connection" has found general acceptance, various methods have been applied in determining nationality of legal persons.

The first method is to determine the place of *incorporation* of the TNC, i.e. the state/country under which laws the TNC was established.

The second method is the *siège social*, i.e. the state/country which is the principal seat or centre of administration or headquarters of the TNC.

The third method is related to *control or substantial interest*, i.e. nationality is established on the basis of the nationality of shareholders who hold majority shares or substantial portion of the shares.

Source: Astorga (2006); UNCTAD (2016).

The used definition of FDI affects the data available on FDI. The components of FDI are equity capital, reinvested earnings and other capital (mainly intra-company loans). **Equity capital** comprises equity in branches, all shares in subsidiaries and associates (except non-participating, preferred shares that are treated as debt securities and are included under other direct investment capital) and other capital contributions such as provisions of machinery, etc. **Reinvested earnings** consist of the direct investor's share (in proportion to direct equity participation) of earnings not distributed, as dividends by subsidiaries or associates and earnings of branches not remitted to the direct investor. If such earnings are not identified, all branches' earnings are considered, by convention, to be distributed. **Other direct investment capital** (or inter-company loans) covers the borrowing and lending of funds, including debt securities and trade credits, between direct investors and direct investment enterprises and between two direct investment enterprises that share the same direct investor. As countries do not always collect data for each of those components, reported data on FDI are not fully comparable across countries. In particular, data on reinvested earnings, the collection of which depends on company surveys, are often unreported by many countries. In addition, the incidence of "round-tripping" also often distorts the actually reported inflows of FDI in any given country (box 1.3).

Box 1.3. Distorting foreign direct investment inflows: Round-tripping

FDI is often associated with particular benefits for host countries, including a net financial inflow. However, if a resident investor in a given country channels funds abroad and then returns the funds to the country in the form of FDI, the associated benefits of FDI will not materialize. This phenomenon is known as "round-tripping." Round-tripping is not genuine FDI and may reduce tax receipts and regulatory oversight in the country of the resident investor.

The extent of round-tripping varies but can be quite substantial for some countries. For instance, exploratory estimates for the Russian Federation indicated that more than half of the country's outward FDI position at the end of 2010 consisted of funds that were eventually returned through round-tripping.[6] In the case of China, Hong Kong, China plays an important role in each of the three stages of capital's journey: (1) the original creation of new capital in China, (2) the capital flight out of China and (3) the round tripping FDI back to China. This accounts for the fact that Hong Kong, China turns up as a major foreign investor in China which is due, to a large extent, to round-tripping (Xiaou Geng, 2004). Offshore financial centres, such as British Virgin Islands, Bermuda, and Cayman Islands, play a similar role.[7]

Round-tripping may happen for the following reasons:

- Economies sometimes offer tax or other incentives to foreign investors to locate in their economy. If local investors do not receive this same preferential treatment, then they may engage in round-tripping to receive these benefits.
- Some economies have controls on capital movements or exchange rates that may lead domestic investors to round-trip to have more flexibility in managing their capital.
- Some economies may not have well-developed capital markets; so domestic investors first invest overseas to access better financial services and then return the funds to the home economy.
- If an economy has investment treaties that give greater protections to foreign investors, domestic investors may round-trip to ensure their investments receive these greater protections.
- Some investors may want to conceal their identity.

[6] Central Bank of the Russian Federation, "Identifying round-tripping of funds: a note by Russia," presented at the meeting of the OECD's Working Group on International Investment Statistics, 3-5 October 2011. Quoted in Borga (2016).

[7] Recent data and information on round-tripping of FDI in China can be found in Loewendahl and others. (2016).

OECD's BMD4 recommends that countries compile statistics on inward FDI by the ultimate investing country. Given the often-complex ownership structures of TNCs, this allows countries to identify the country of the direct investor that ultimately controls an investment and, thus, bears the risks and reaps the rewards of the investment. The presentation by ultimate investing country identifies the amount of round-tripping in an economy by identifying that portion of inward investment that is controlled by a resident of the host economy. In contrast, the standard presentation of FDI statistics is by the immediate source of funding. However, as box 1.2 demonstrated, it is not always easy to determine who the ultimate investing country is.

Source: Borga (2016), Reprinted with permission from the Columbia Center on Sustainable Investment; Xiao Geng (2004).

Countries differ in the threshold value for foreign equity ownership which they take as evidence of a direct investment relationship. This is the level of participation at or above which the direct investor is normally regarded as having an effective say in the management of the enterprise involved. The threshold value usually applied for FDI is 10%. Some countries do not specify a threshold point, but rely entirely on other evidence, including companies own assessments as to whether the investing company has an effective voice in the foreign firm in which it has an equity stake. The quantitative impact of differences in the threshold value used is relatively small, owing to the large proportion of FDI which is directed to majority-owned foreign affiliates.

B. A TYPOLOGY OF FOREIGN DIRECT INVESTMENT

FDI can be distinguished into various types. A common typology is by the **form** it takes.

- The creation of a new subsidiary and/or manufacturing base or services centre in the host country (often referred to as "greenfield FDI");
- Mergers and acquisitions (M&A) of existing businesses in the host country;
- Joint ventures (JVs);
- Re-investment of profits into projects in the host country.

Greenfield FDI refers to fresh capital investments resulting in capital inflows to a host country of the investment and the formation of new assets. The leading global database on cross-border greenfield investment based on company investment announcements is fDi Markets of the Financial Times Ltd. (**https://www.fdimarkets.com**) which can be accessed for a fee. In contrast**, mergers and acquisitions** (M&A) refer to the take-over of or merger of the investing company with a domestic company in the host country of the investment. It typically involves the buying of a local company by a foreign investor and, as a result, this form of investment does not create new assets but does constitute a capital inflow to the host country. The leading global database on M&A is provided by Thomson Reuters (**https://www.thomsonreuters.com**), which can be accessed for a fee at **http://dmi.thomsonreuters.com/DealsIntelligence**.[8] **Brownfield investment** occurs when a company or government purchases or leases an existing facility to begin new production but can also refer to expansions made by existing foreign investors in a given host location or re-investment in existing foreign affiliates or sites. Most commonly, brownfield investment occurs when a company closes down an operation and then sells the operation to another company.

FDI can also be categorized by **ownership** patterns. A foreign investor can have a majority stake in a foreign venture/investment (**majority-owned FDI**), fully own the foreign venture/investment (**wholly-foreign-owned FDI**) or enter into a **joint venture** (JV) with another (local) company. Under a joint venture, new assets are created with joint ownership while revenues, expenses and assets are shared. Joint ventures are sometimes the only approved entry of FDI into a host country and can be a convenient way for foreign investors to navigate the investment environment and requirements in a new host country. However, local JV partners may not necessarily have the required capacity to efficiently operate an enterprise or contribute to the investment objective of the foreign investor. Choosing the right JV partner is therefore essential and not always easy.

[8] For more information on the M&A database of Thomson Reuters, see: **http://financial.thomsonreuters.com/content/dam/openweb/documents/pdf/financial/mergers-and-acquisitions.pdf.**

More commonly, FDI is categorized by the **purpose** of the investment. Traditionally, FDI was distinguished by FDI that sought to exploit foreign markets (market-oriented FDI) and FDI that established a presence to exploit competitive advantage in foreign countries for export purposes (export-oriented FDI). However, the categorization of FDI by purpose has become slightly more complicated. The following types of FDI can be distinguished (Dunning, 1993):

- **Market-seeking FDI** is greenfield FDI motivated by exploiting market opportunities in foreign countries. Markets are attractive in countries with relatively large populations that have rising purchasing power. While those markets can be served by exports, it is often more cost-effective to establish a presence in foreign markets and to improve customer service. Some products can only be delivered through a market presence (e.g. a MacDonalds hamburger cannot be exported) or only through exports (e.g. a Boeing passenger plane).
- **Resource-seeking FDI** is greenfield FDI motivated by the presence of natural resources in a foreign country which are not available, or insufficiently available, in the home country and can only be explored and exploited through a presence in the foreign country. It also refers to tapping affordable or "cheap" labour in a foreign country as compared to the costs of labour in the home country of the foreign investor.
- **Efficiency-seeking FDI** is greenfield FDI motivated by the need for TNCs operating large global production networks and value chains to find and invest in locations where a particular part of the production process (e.g. research and development (R&D), production of parts and components, delivery of particular services) can be undertaken most efficiently in conformity with the competitive advantage of that location. This type of FDI has become increasingly important in recent decades. A typical form of efficiency-seeking FDI is known as "vertical" FDI (see box 1.4)
- **Strategic asset-seeking FDI** is motivated by the desire of investors to establish a presence in a foreign (host) country through the acquisition/purchase of a local company. This type of FDI takes the form of M&A.

Box 1.4 Horizontal vs. vertical foreign direct investment

The rapid proliferation of global value chains is a result of TNCs locating different parts of the production process in different countries depending on the competitive advantages of each host country. This has led to the rapid increase in vertical FDI. Vertical FDI takes place when a firm through FDI moves upstream or downstream and invests in different stages of the value chain in different countries (this would relate to efficiency-seeking FDI). It takes two forms: (a) backward vertical FDI: where an industry abroad provides inputs for a firm's domestic production process, such as a manufacturing company engaging in resource-seeking FDI (to secure raw materials for production rather than buying them from independent companies); and (b) forward vertical FDI: in which an industry abroad sells the outputs of a firm's domestic production processes. Horizontal FDI arises when a firm undertakes the same home country-based activities at the same level of the value chain in a host country through FDI (either for servicing the local market rather than exports to the market or use the market for exports to a third country). Market-seeking FDI, i.e. FDI by global retailers such as Walmart or Tesco Lotus or fast food chains such as McDonalds or KFC are typical examples of horizontal FDI. The production of a certain model of cars in various markets with minor modifications (e.g. Toyota Camry in various countries) is another example. In this case, FDI is not necessarily market-seeking in the host country only but may use host countries as production bases for export to third countries. Horizontal FDI is often seen to avoid the costs of exports by "tariff-jumping", i.e. as import tariffs are relatively high in a country, exports to that country may become prohibitively expensive and the firm therefore prefers to invest directly in the target market rather than service the market through exports. However, as non-tariff barriers have replaced tariffs as the principal barrier to trade, tariff-jumping is no longer a main consideration for most foreign investors.[9]

Source: ESCAP.

Efficiency-seeking FDI involving equity holdings by TNCs has been the traditional way for TNCs to manage their global production networks. Increasingly, TNCs are resorting to non-equity modes of international production to manage and expand their global value chains. Through these modes, TNCs increasingly control and coordinate the operations of independent or, rather, loosely dependent partner firms, through various mechanisms. The non-equity modes include, for example, contract manufacturing, services outsourcing, contract farming, franchising

[9] See, for instance, Nunnenkamp (2002) and Tekin-Koru (2004) on the diminishing role of tariff jumping as a determinant of FDI.

and licensing, as well as other types of contractual relationship through which TNCs coordinate and control the activities of partner firms in host countries (UNCTAD, 2011).

C. SUSTAINABLE FOREIGN DIRECT INVESTMENT

In recent years, and in particular in connection with the formulation and achievement of the Sustainable Development Goals (SDGs), increased attention has been paid to the concepts of "sustainable" and "social" FDI or investment. With reference to the three dimensions of sustainability, i.e. economic, social and environmental, **sustainable FDI** can be defined as FDI that contributes to sustained economic growth, is socially inclusive and environmentally sustainable. The goal of host countries is to attract FDI that contributes to sustainable development. In fact, a fourth dimension of good governance can be added which would give sustainable FDI four dimensions that all contribute to a host country's sustainable development:

- *Economic development*: linkages, technology transfer, training, etc.
- *Environmental sustainability*: minimizing adverse impacts, mobilizing conservation (energy efficiency/ renewable energy) technologies, etc.
- *Social development and inclusion*: labour and employment standards, community health and consultations, education, training, etc.
- *Good governance*: fair and efficient negotiations, contracts, adherence to international standards of responsible business conduct, etc.

In addition, **socially responsible investment** can be defined as investment that factors environmental, social and (corporate) governance (ESG) factors in decision-making (negative screening) of investors while **social investment** and **impact investment** refers to investment that seeks a maximum impact on creating social value or a social/environmental good (profit or non-profit) (positive screening). Socially responsible investment and social/impact investment can be both FDI and FPI. In the case of impact investment, profits are not the primary goal unless it is for the purpose to channel profits into social investment rather than as a reward to shareholders.

The concept of good governance in this regard refers to the ethics and responsible conduct of the TNC, i.e. the foreign investor. International voluntary standards, guidelines and principles exist to promote such conduct, i.e. the United Nations Global Compact, ISO 26000, Global Reporting Initiative and sectoral standards. It also encompasses the concept of **corporate social responsibility** (CSR) though CSR has increasingly been interpreted by companies as a modality for business to contribute to achieving social goals outside the primary goal of profit maximization rather than a modality to improve the social and environmental performance of the company itself, which is more important. The importance of good governance in the host country, which is a government responsibility, is discussed below.

There is clearly a rationale for TNCs to enhance their own sustainability as it contributes to revenue, mitigates risk and increases overall enterprise value as explained by Loewendahl and others., (2017). In particular:

1. How sustainable development practices can increase company revenues and enterprise value?
   (a) Maintain competitive position: Keep up with competitors who adhere to and actively promote higher standards;
   (b) Differentiate products: Differentiate products or services to gain share and/or command price premium (e.g. fair trade, Rainforest Alliance, etc.);
   (c) Capture revenues and build loyalty: Develop new revenue streams by accessing new customers and markets, and build awareness and brand loyalty among customers as well as shareholders;
   (d) Increase employee loyalty: Recruit, retain and motivate employees who share these values;

2. How sustainable development practices can mitigate risks?
   (a) Preserve license to operate: Mitigate risk of disruption to operations or increased cost of doing business due to regulatory action from causing pollution and other natural or human disasters;
   (b) Avoid reputational damage: Mitigate risk of lost revenue due to reputational damage through promoting traceability and measuring and communicating social and environmental impact;
   (c) Avoid future supply disruptions: Mitigate risk of future scarcity of supply and resulting price increases through supporting sustainable development in suppliers, especially smallholders.

The concept of sustainable FDI is further explored in chapter 3 while impacts of FDI on economic and sustainable development are discussed in chapter 2.

D. RATIONALE FOR FOREIGN DIRECT INVESTMENT

Many theories have been proposed explaining FDI. Most have focused on market imperfections, internalization, ownership of firm-specific assets and advantages, and host country advantages. **Internalization** refers to the preference of firms to keep a transaction, i.e. production, within the firm (e.g. through investing abroad) rather than transfer it to the open market through a licensing arrangement, joint venture or other transfer involving other firms, if there is a cost advantage in doing so. Stephen Hymer (1960) was the first to recognize that FDI was not merely a financial flow but involved the transfer of a package that consisted of assets, technology and knowledge (owner-specific intangible assets) and that FDI was motivated by firm-specific advantages where the foreign investor had a competitive advantage over the domestic firm and could exploit market imperfections. Firms would engage in internationalization of production to mitigate risk and mitigate conflict with rival firms (by taking them over) but would basically seek to gain monopoly power and subdue competition.

The **eclectic paradigm,** proposed by John H. Dunning (e.g. 1977, 1980, 1988), links firm-specific advantages, internalization theory and location theory. This eclectic theory attempts to explain internationalization motives stemming from advantages resulting from the interaction of three interdependent elements: i.e. ownership, location and international environment. In fact, it is the integration of location-specific characteristics which forms the distinction between the eclectic paradigm and other theories since this theory allows predicting the geographical areas where the probability for firm internationalization is the highest. Internationalization of firms, including FDI, according to Dunning, is beneficial if three conditions are met: (1) The firm possesses **O**wnership (i.e. firm-specific) advantages in comparison to local firms; (2) It is beneficial to **I**nternalize these ownership advantages within the firm or firm network rather than use the market to pass them to foreign firms by selling and leasing them to other companies; (3) **L**ocation advantages exist which motivate firms to exploit their firm-specific advantages in foreign markets rather than (only) in home markets.

All in all, the eclectic paradigm consists of three advantages (i.e. **O**wnership, **L**ocation and **I**nternalize) that combined form the **OLI-model**. These different elements overlap and interact.

This interaction determines which market entry strategy firms choose to internationalize.

- **O**wnership advantages: knowledge resources on the one hand and management assets on the other hand, including brand, image, managerial capabilities, technology, firm size, patents, trademarks, know-how, exclusive access to inputs, assets and/or markets;
- **L**ocation advantages: advantages that arise from being active in a foreign location which offers unique assets and resources generated by economic, political and social and cultural factors; and
- **I**nternalize advantages: the use of firm-specific knowledge (and intellectual property), the internal firm market and firm structure such as its networks, specialization and size.

Table 1.1 below illustrates how these three advantages determine the modality of market entry. Modalities are licensing, exports and FDI. FDI is distinguished from the other modalities of market entry in that all three advantages need to be present in order for FDI to take place.

Table 1.1. Modalities for foreign market entry by advantage

Modality of market entry	Type of advantage		
	Ownership	Internalization	Location
Licensing	**Yes**	No	No
Exports	**Yes**	**Yes**	No
FDI	**Yes**	**Yes**	**Yes**

Source: J.H. Dunning, *International Production and the Multinational Enterprise* (London, George Allen and Unwin, 1981).

Critiques argue that the paradigm entails an extremely wide range of variables and, therefore, loses usability and is not fully compatible with the typology of FDI proposed by Dunning. Another critique is that the paradigm exclusively applies to large firms since they benefit from their organizational capacities. Leaving out firm's behaviour determinants has also frequently been mentioned as a comment.[10] In response, Dunning extended his paradigm in the 1990s by including "management strategy" as a clear variable, as well as "alliance capitalism"[11] and the increased role of technology (Dunning, 1997). In any case, the rationale and determinants of FDI (see below) are increasingly complex and differ by type and form of FDI. Research in this area is still a work in progress.

E. DETERMINANTS OF FOREIGN DIRECT INVESTMENT

1. General overview

This section builds on the previous section in examining in more detail the determinants of (greenfield) FDI, in particular those related to the location of an investment. Three categories of determinants can be distinguished, which mostly apply to greenfield FDI (table 1.2). The first two categories are directly related to host country location determinants (the L in the OLI model) while the third category relates to ownership and internalization determinants (the O and I in the OLI model).

Table 1.2. Determinants of FDI

1. Economic conditions	• Markets	Size and income levels; level of urbanization; stability and growth prospects; access to regional markets (e.g. ASEAN Free Trade Area (AFTA)); distribution and demand patterns.
	• Resources	Natural resources; technology and skills resources; labour resources.
	• Competitiveness	Availability of affordable and productive labour force: costs, skills, trainability, managerial skills; access to inputs; physical infrastructure (water, electricity and other energy, roads, railways, ports, telecommunications, etc.); supplier base; R&D; financial institutions.
	• Macroeconomic fundamentals	Tax rates and structure, inflation rate, exchange rates, interest rates, external debt, etc.
2. Host country policies and legal framework	• Macroeconomic policies and laws	Fiscal and monetary policy; ease of remittance and repatriation; access to foreign exchange.
	• Private sector policies and laws	Promotion and degree of private ownership; clear and stable policies; easy entry/exit policies; efficient financial markets; government procurement; other support.
	• Trade and industry policies and laws	Import and export controls/liberalization policies; membership in regional trade and integration agreements; competition policy; support for SMEs; intellectual property rights (IPR) protection.
	• FDI policies	Membership and nature of international investment agreements. Ease of entry; pre-establishment and post-establishment: most-favoured-nation (MFN) treatment and national treatment; ownership; incentives; access to inputs; stability and transparency of policies and laws; availability of information and assistance; active investment promotion and targeting by efficient investment promotion agency; aftercare services for investors.

[10] For a review of the criticism and putting the OLI model in context, see for instance, Franco and others (2008).

[11] Alliance capitalism refers to a system of network of inter-company collaboration mechanisms or inter-corporate alliances which are formed with the purpose to maximize profits and access to markets such as the Japanese Keiretsu. Such collaboration may lead to collusion and anti-competitive practices but is increasingly common in a globalized world, including through mergers and acquisitions.

Table 1.2. (continued)

3. TNC strategies	• Risk perception	Perception of country risk based on political factors and macro-economic management, labour markets, policy stability, IPR protection.
	• Location, sourcing, integration, transfer	Company strategies on location, sourcing of products/inputs, integration of affiliates and supply chain management, strategic alliances.

Source: Based on Lall (1997).

The specific determinants depend on each type of FDI and the sector in which FDI takes place (box 1.5). For instance, resource-seeking FDI is mostly interested in the availability of natural resources in a given host country, protection of the investment and political stability. Market-seeking FDI is mostly interested in a large and growing market. Efficiency-seeking FDI looks for cost cutting, e.g. the availability of cheap labour or availability of skilled labour, IPR protection and sophisticated R&D in higher end technology-intensive FDI. Strategic-asset FDI looks mostly for target companies in host countries which fit in the TNC strategy and are relatively easy to be purchased, in particular if the host country is experiencing an economic crisis. FDI in manufacturing looks at the trade regime (if it is import dependent), exchange rates and supplier base, cheap labour and labour productivity while FDI in services looks mostly to the regulatory environment for the particular services sector (e.g. telecommunications, banking).

Box 1.5. Location factors for foreign direct investment

According to a UNCTAD survey (UNCTAD, 2009), the most important factors influencing location selection are market factors and overall business environment. Table 1.3 below shows the result of the survey. Local market size was the most frequently cited – large economies, either developed or emerging, are favoured. Market growth is another leading factor. Presence of suppliers and partners – linkage and industrial cluster effect, also has a significant impact on site selection. For access to regional markets, countries integrated or close to large markets are favoured.

The importance of these location factors, however, differs between industries, functional activities, entry modes, etc. (OECD, 2011). For example, table 1.3 indicates the criteria by sector. The leading factors in the manufacturing sector and services sector are the same, while the primary sector has different criteria. Access to natural resources is the most cited factor for the primary sector. And market-related factors are significant in the manufacturing and services sectors. The differences between sectors also indicate the impact of strategic motivation on site selection. According to Dunning's OLI framework, market-related location factors such as market size, market growth potential, and consumers' buying power, are crucial for market-seeking investments. Resource-seeking investments typically favour countries with relatively cheap and abundant scarce resources. Efficiency-seeking investments would seek for economies of scale and rationalize operations. And asset-seeking investments are likely to select the location with an access to technology and other productive capabilities (OECD, 2011).

The eclectic paradigm focuses on economic efficiency, while institutional factors should also be considered when analysing FDI location selections. (Kostova and others, 1999; Dunning and Lundan, 2008; Voss and others, 2009).

Table 1.3. Leading factors influencing the location of companies, 2009-2011 (% of responses)

Size of local market	17
Growth of market	16
Presence of suppliers and partners	10
Access to international/regional markets	10
Stable and business-friendly environment	8

Source: UNCTAD (2009).

For all types of FDI, the allowed ownership and ease of entry matters as well as the availability and cost of labour and overall cost of doing business. Generally speaking, the following determinants are important for most types of FDI and have not fundamentally changed over time:

- Open economy, high growth (e.g. China, India);
- Rule of law and economic policy coherence (e.g. Singapore, Thailand);
- Political and economic stability (e.g. China, Singapore);
- Cheap and productive labour (e.g. ASEAN, China, India);
- Natural resources (e.g. Indonesia, Azerbaijan, Kazakhstan);
- Large market (e.g. China, India, Indonesia, AFTA);
- Physical, financial and technological infrastructure facilities (e.g. Singapore, Hong Kong, China, Thailand);
- Access to markets and trade facilitation (cross-border zones and areas, e.g. ASEAN Investment Area (AIA), growth triangles);
- Investment protection and promotion (especially important in the mining industry);
- Good governance, quality of institutions and absence of red tape (Hong Kong, China, Singapore).

2. Linking foreign direct investment to national competitiveness

The attractiveness of a country/locality as an investment destination depends on the general development level of the country/locality. In other words, while governments of developing countries put much emphasis on FDI as a contributor to national economic development, a minimum level of development is actually required to attract FDI, unless the country has a unique characteristic or natural resources that can be easily exploited. However, for more upstream manufacturing activities and more sophisticated services industries, TNCs look for countries which offer the best facilities for the least cost. Using Michael Porter's analytical model of determining national competitive advantages (figure 1.1), the following determinants for both inward FDI (from the host country's perspective) and outward FDI (from the home country's perspective) can be distinguished (Porter, 1998).[12]

(a) Factor conditions: the nation's position in factors of production necessary to compete in a given industry. This component is of particular relevance to resource-seeking and efficiency-seeking FDI. However, factors of production go beyond only capital and labour and may be categorized as human resources, physical and natural resources, climate, location, unskilled labour and capital, but also advanced factors that are created such as modern infrastructure, universities, and highly skilled labour. Countries with a relatively large pool of advanced factors, including highly specialized factors that are used by firms in an effective and efficient way in particular industries, gain a competitive advantage in those industries, with high potential for FDI from the industries' firms. However, firms from countries with selective factor disadvantages may feel compelled to invest abroad to tap resources in other countries where these factors (usually those that are fixed) are relatively abundant. At the same time, the country's possession of both traditional and advanced factors forms a strong determinant for foreign investors to invest in that country. Not only is the availability of certain factors important, but so is their costs. Thus, while traditionally FDI has been motivated by low costs and, hence, cheap labour availability, increasingly the quality and skills of labour also matter in most industries. There is indeed evidence that the majority of manufacturing FDI in developing countries flows to more advanced industrial sectors, and the weighting towards more skill-intensive investor operations is speeding up over time (Moran, 2015). As a result, a proper mix of low costs and high skills are a main determinant for FDI in the labour-intensive industries. With regard to infrastructure, not only does the availability of roads and airports and telephone lines matter, but in the globalizing world, access to high-speed Internet connection and overall information and communications technology (ICT) capabilities of a country figure prominently in the selection of localities by TNCs.

(b) Demand conditions: the nature and size of home demand for the industry's product or service. This component is of particular relevance to market-seeking FDI. Both quantity and quality of home demand are important. It is not only the size of home demand that affects competitive advantage, but also the composition of demand. Nations gain competitive advantage in industries or industry segments where the home demand gives local firms a clearer or earlier picture of buyer needs than foreign rivals can have, and pressure local firms to innovate faster and achieve more sophisticated competitive advantages compared to foreign rivals. A large and growing pool of sophisticated and demanding buyers in a country greatly contributes to gaining competitive

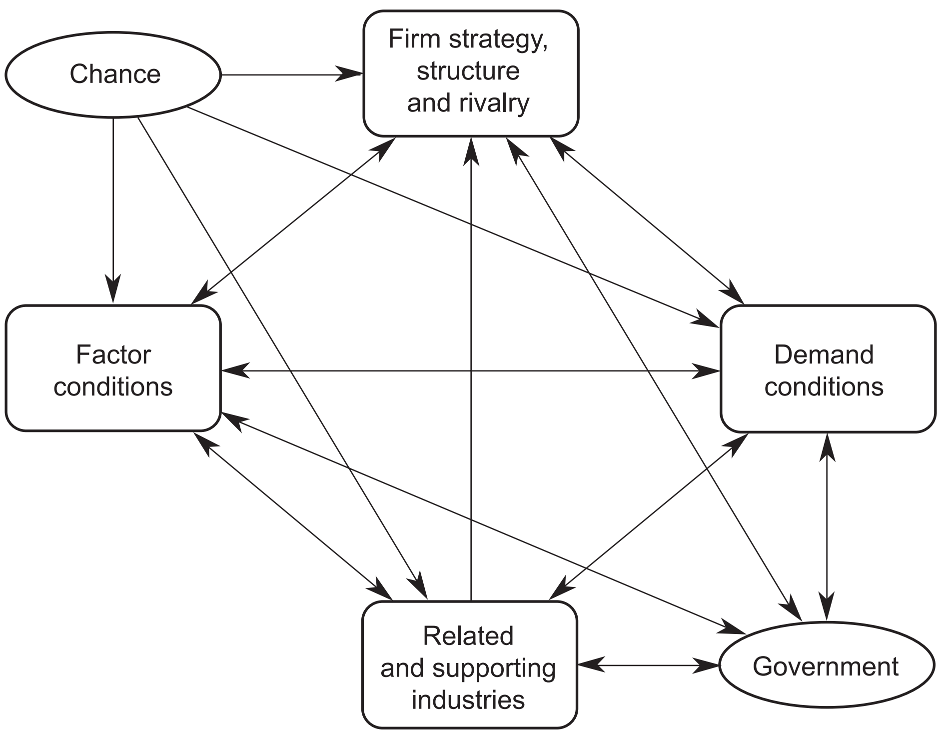
[12] The diamond model is an economic model developed by Michael Porter explaining why particular industries become competitive in particular locations. He distinguished four core determinants of national competitive advantage that interact which each other along with two additional factors affecting the other four consisting of government and chance events that are out of control of business and governments. While the model has lost some relevance with the growth of global value chains and does not allow for foreign activity, it still offers a good framework for analysis of determinants of FDI inflows (and outflows) at the national level leading to policy recommendations (chapter 3).

advantage in a particular industry and therefore by selected companies in that industry, which are often the more experienced TNCs. Of importance in this context is also the way by which a nation's domestic demand internationalizes and pulls a nation's products and services abroad. If buyers are mobile and include TNCs, or if a country's specialized universities attract foreign students, for example, the country's products will be in demand abroad and FDI from the country is likely to follow. At the same time, of course, a country with large and sophisticated demand is very likely to attract FDI which is domestic-market oriented. Countries such as India and China are cases in point where rising levels of income offer enormous potential for TNCs.

(c) Related and supporting industries: the presence or absence in the country of supplier industries and related industries that are internationally competitive determines the competitive advantage of local firms in a particular industry and the extent to which these firms will invest abroad. Conversely, an industry with many firms investing abroad will pull related and supporting enterprises, in particular in services and supplier industries abroad. The more linkages exist in an industry, the more FDI will emanate from the country with that industry, once a few firms in the industry or in related or supporting industries start investing abroad. With regard to inward FDI, the presence of related or supporting industries is a main draw-card for efficiency-seeking FDI and important in the context of integrating into GVCs. TNCs are more likely to invest in countries where local firms can provide high quality goods and services. Where such firms do not exist, supporting enterprises from the home country may follow the larger TNCs and invest in the host country. However, if those supporting industries are locally available, the host economy tends to benefit more. Relationships with domestic supporting industries often take place through subcontracting arrangements where the local enterprise benefits from its links with the TNC. Therefore, the establishment of backward linkages between TNCs and local (often small and medium-sized) enterprises is an important development tool.

(d) Firm strategy, structure and rivalry. The fourth broad determinant of national competitive advantage in an industry is the context in which firms are created, organized and managed as well as the nature of domestic rivalry. While the first category of FDI determinants refers to firm-specific characteristics, related to individual firms, this determinant of national competitive advantage refers to the unique corporate culture in a particular country on a country-wide basis as goals, strategies, and ways of organizing firms in industries vary widely among countries. Some cultures are more likely to result in FDI than others. More important, the pattern of rivalry at home also has a profound role to play in the process of innovation and the intimate prospects for international success. While higher intensities of competition in a given industry in a country would result in a higher chance

Figure 1.1. Michael Porter's "diamond" of determinants of national competitive advantage



Source: Porter (1990, 1998).

that firms in these industries would engage in FDI and would extend their “battlefield” abroad, even at the global level, such industries would also attract FDI, in part because of the global character of competition that national rivalry would lead to, but also because higher-technology investment would be attracted by countries where the strong need for innovation to remain competitive has led to strong universities, R&D institutions, and the like, and consequently a pool of well-educated and highly trained personnel.

It follows that the presence and high level of development of all four determinants would put a country in a position where it acts as both a favourite home and host country for FDI. For this reason, most FDI in the world takes place among developed countries and development means nothing more than a strong presence of the four determinants of national competitive advantage.

The way government influences each of the four determinants through a host of policies (in particular its spending and regulations) is important to explain national competitive advantage and FDI patterns (chapter 3). In particular, foreign investors look for countries with governments that promote or do not hinder FDI and offer a stable political climate. In particular, foreign investors look for countries with laws and regulations conducive to investment that are actually implemented and enforced in a non-discriminatory manner. Countries with open liberal trading regimes (membership in the World Trade Organization – WTO) also stand out as favoured investment destinations. Chance events also play a role and are important because they create discontinuities that allow shifts in competitive position and FDI patterns and opportunities. Cultural factors, including social norms and values and languages similar to those of the home country of the investor, also play an important role in the determination of competitive success and FDI, though such factors differ widely among countries and regions and are decreasing in importance in an increasing globalized world.

3. Importance of an enabling business environment and good governance

While all determinants play a role to various extents depending on the type and form of FDI, the importance of good governance as a determinant for FDI cannot be stressed enough. Governments and IPAs have traditionally focused on attracting FDI through marketing and offering incentives, but are increasingly aware of the need to improve the national business environment. However, more often than not, investors attracted by IPAs to invest in new locations are often still confronted with unanticipated administrative obstacles, especially in emerging and developing economies, where a lack of efficiency and capacity within the public sector contributes to bureaucratic red tape, unexpected delays and poor services. Governments can address such issues by adhering to the principles of good governance. Generally, four elements of good governance are distinguished (UNCTAD, 2004):

- **Predictability:** Potential investors evaluate new projects and the risks involved. A high degree of uncertainty can easily be a disincentive. Clear policies and a comprehensive transparent and predictable legal and institutional framework are therefore crucial and must gain an investor’s confidence. Predictability is perhaps the most important concern of investors and can be leveraged through laws and regulations that stipulate the criteria by which government officials take decisions. Greater degrees of predictability are assured by clearer standards of application, reducing the risk for a potential investor. Absence of predictability will create disrespect for the rule of law, increase opportunities for corruption, misallocation of resources and divert investments.
- **Accountability:** To prevent corruption and secure that civil servants perform their required tasks correctly, it is necessary not only to have clear standards of application, rules and frameworks (i.e. predictability) but also to have in place adequate sanctions and means to detect offences. Such legislation includes anti-corruption laws and mechanisms to inspect reported cases. Legal accountability and attitude interact as civil servants may not see investors as parties to whom they are accountable for prompt, competent and impartial performance of their duties. Performance standards and monitoring could enhance the accountability and effectiveness of government officials whilst simultaneously reducing corruption risks.
- **Transparency:** Availability of relevant laws and regulations in English is important for investors to evaluate their potential investment locations. Similarly, the availability of English language websites (or any other language than the national language) helps foreign investors navigate the new investment location. Greater openness and open information disclosure through media and information technology (IT) enhances the efficiency of interface between governments and investors.

- **Participation:** To find the right balance between the interests of the public sector and the private sector in regulatory frameworks on investment is a challenge. While the public sector pursues development, the private sector pursues maximization of profit and shareholder value. The public sector, including policy makers, regulators, legislators and enforcers, is accountable for the consequences of the adopted regulatory framework. Such a framework should contribute to inclusive and sustainable development while providing an enabling environment for business. The private sector must share the responsibility by adhering to regulatory frameworks, responding when consulted and adopting self-regulatory measures to reduce the enforcement burden on government. Interaction between the government, stakeholders and investors before, during and after policy is developed and legislation is enacted is highly desirable. In sum, frequent consultations between government and business through meaningful public-private sector dialogues contribute to the legitimacy and effectiveness of policies, laws and regulations.

F. DISCUSSION ISSUES

1. What is more important in your country: FDI or FPI and why?
2. What do you think are the most important types and forms of FDI in your country? How important is greenfield investment in your total FDI inflows?
3. Does the type and form of FDI differ across localities in your country (e.g. provinces, cities, special economic zones, border areas, etc.)?
4. What do you think are the main attractions for FDI to invest in your country/locality? What are the main determinants of FDI in your country/locality?
5. Does your country have specific rules and regulations for FDI on the basis of nationality of the investor? Have you encountered difficulties in ascertaining nationality?
6. To what extent is round-tripping a problem in your country? Is it being addressed?
7. Referring to the determinants of national competitive advantage, which of the four is the strongest in your country and which is the weakest? To what extent you think your country has overall competitive advantage?
8. Do you think FDI in your country contributes to sustainable development? Is FDI itself sustainable?
9. To what extent do you think the principles of good governance are applied in your country/locality?

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CHAPTER TWO

2

FOREIGN DIRECT INVESTMENT TRENDS AND IMPACTS

A. FOREIGN DIRECT INVESTMENT DEVELOPMENTS AND TRENDS

1. Global and regional trends in inward foreign direct investment flows

One of the major developments in FDI in the past three decades has been the dramatic increase in global FDI flows from $205 billion in 1990 to $1.76 trillion in 2015, despite sharp drops in the wake of the global economic crisis of 2008.[13] One of the main drivers of this trend has been the increase in FDI flows to developing countries, mainly those in the Asia-Pacific region as a result of the change in attitude towards the role of FDI in economic development (box 2.1). The region has continuously increased its share of the global FDI inflows reaching 32% of global inflows in 2015 (figure 2.1). Also noteworthy is the rapid increase of FDI in services in the region. However, in terms of greenfield FDI, the manufacturing sector continues to be the main destination sector (figure 2.2). In particular, FDI in the manufacturing sector is led by changes in production processes and expansion of global value/supply chains which has prompted the relocation of significant phases of production by TNCs to countries where production costs are low and/or abundant labour is available. The Asia-Pacific region has attracted large amounts of efficiency-seeking FDI and has clearly outpaced other developing regions in this regard.

Box 2.1. The changing attitude of host countries towards FDI for development

Though FDI in a wide sense of the word (i.e. citizens from one political entity undertaking business in another) has been around for millennia, the modern form of FDI is sometimes thought of as originating with American firms, and some of its characteristics as we know it today developed mainly in American companies. It is striking that transnational corporations or the “multinational corporation” play a minor role in descriptions of the period before 1913, the time of perhaps the largest total international investment flows in history, relative to output and fixed investment. Most investment was in the form of portfolio investment, mainly in railways, land plantations, insurance and finance, and utilities.

In the post war period, many developing countries existing today gained their independence. Lacking investment capacity themselves, they focused on developing indigenous economic capacity through import substitution led by the government rather than relying on capital from the former colonial powers they viewed with great mistrust. In any case, the benefits from FDI under an import-substitution regime were limited. Often, foreign investors also interfered in local political processes and were increasingly viewed as agents of their home country governments. As a result, FDI was viewed as a form of neo-colonialism and not favoured as a modality for development.

With growing globalization, many countries switched from import-substitution to export promotion. In this context, developing countries reviewed their position and increasingly saw FDI as a potentially important source of capital, technology and access to international markets. The data on gross direct investment flows indicate that direct investment has been an increasing part of total investment flows since the 1970s and early 1980s, when they were less than 15%. By the first half of the 1990s they accounted for 30% of total outflows and they stayed at that level in the

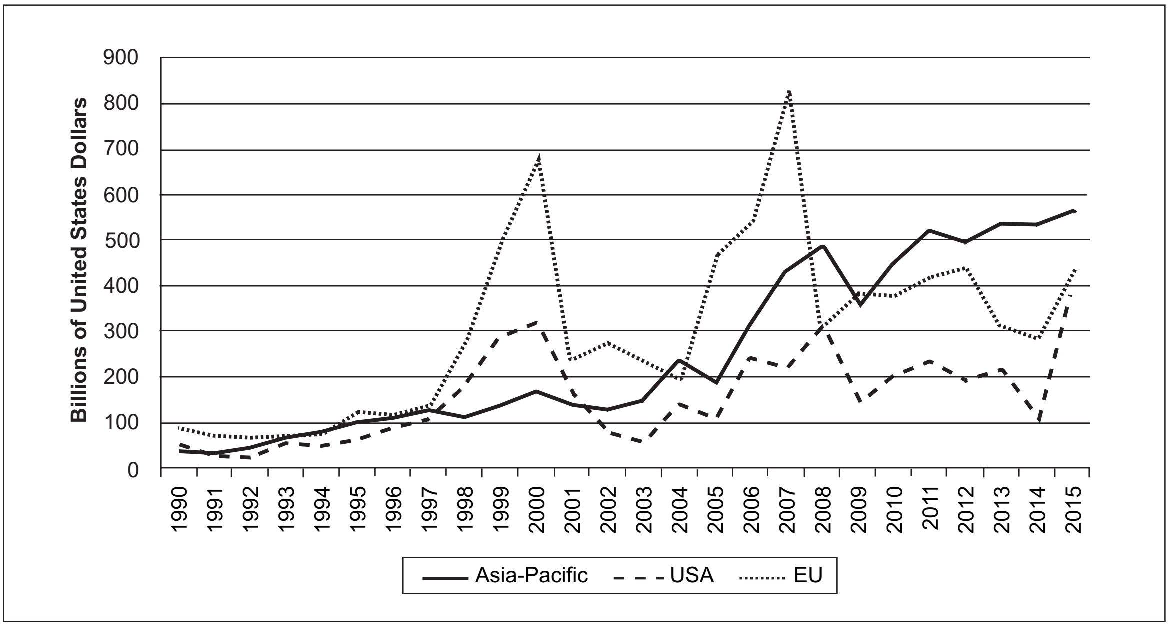
[13] UNCTADstat (2016). Available from **http://unctadstat.unctad.org/EN.**

second half of the decade. However, FDI was still concentrated in developed countries, i.e. the “triad” of Europe, United States and Japan. With the rise of Japanese TNCs in the 1980s and 1990s, helped by the rise of the Japanese Yen, FDI from Japan increased and targeted low-cost emerging economies in East and South-East Asia. At the same time, European and American companies also looked for lower costs and access to natural resources in developing countries with many regimes looking forward to receiving vast amounts of capital inflows. Unfortunately, the sustainability of such FDI was not always part of the picture though that is changing in the last decade. In fact, countries have increasingly competed for FDI through generous incentives and lax labour and environmental regulations while the proliferation of bilateral investment treaties increased investor protection.

With the adoption of the Sustainable Development Goals, countries increasingly look towards the attraction of sustainable FDI flows. At the same time, they no longer look for unbridled liberalization and investor rights but seek to balance the rights of investors with the legitimate development concerns of host countries.

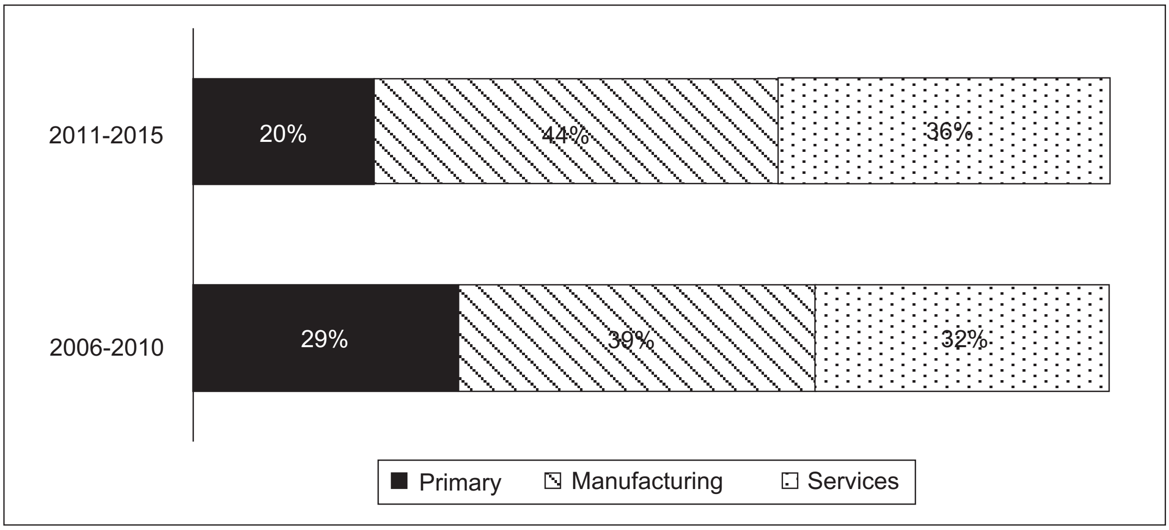
Source: Lipsey (2001).

Figure 2.1. FDI inflows to world regions, 1990-2015



Source: ESCAP calculations, based on UNCTADstat (2016).

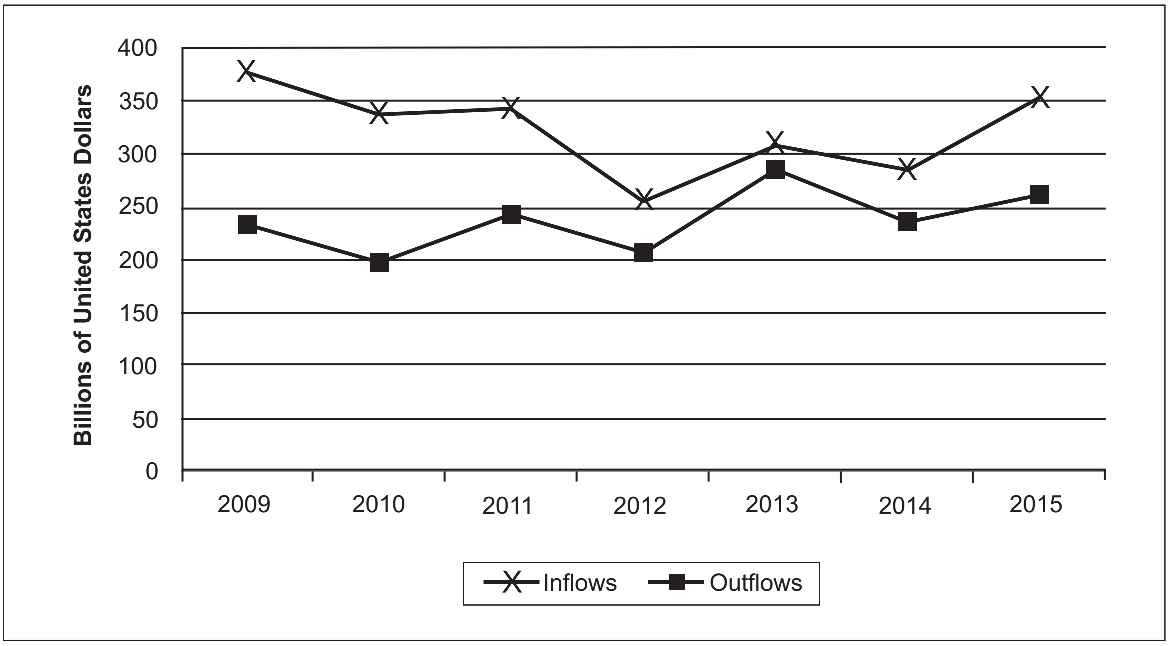
Figure 2.2. Sectoral distribution of greenfield FDI inflows to the Asia-Pacific region, 2006-2015



Source: ESCAP calculations, based on fDi Intelligence data (2016).

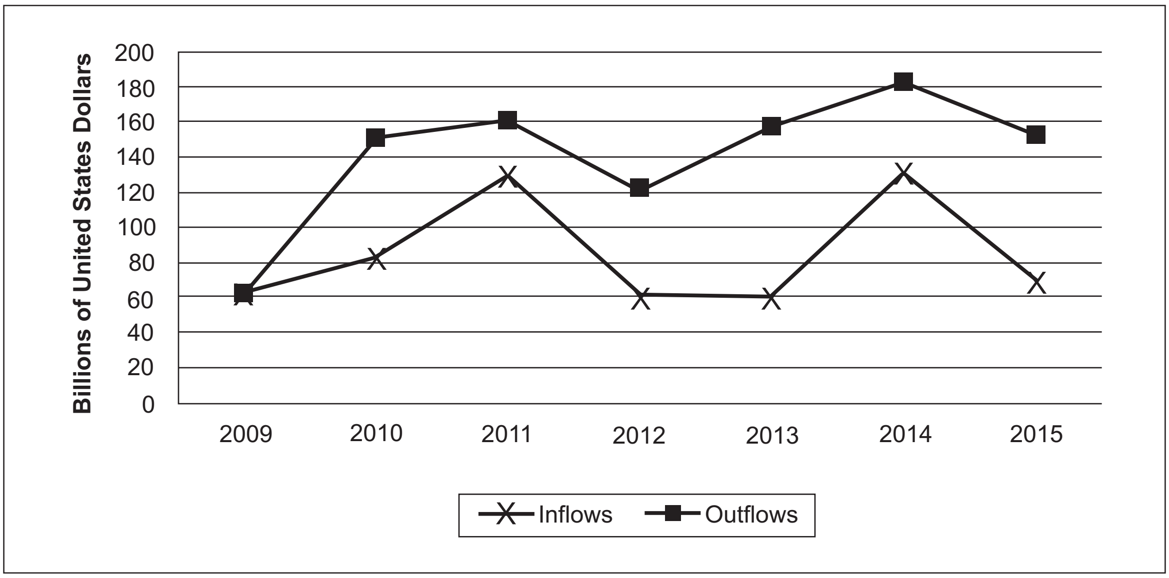
While greenfield FDI to the region has dropped from highs in the mid-2000s, recently modest increases can be noted (figure 2.3). Interestingly, with rising FDI inflows and improving development, FDI outflows from the region have also risen. For FDI flows through mergers and acquisitions (M&A), the annual flows have been fluctuating for the past years. In 2015, the Asia-Pacific region received $68 billion through M&As compared to $6 billion in 1990, $77 billion in 2000 and $81 billion in 2010 (UNCTAD, 2016) (figure 2.4).

Figure 2.3. Greenfield FDI inflows and outflows: Asia-Pacific region, 2009-2015



Source: ESCAP calculations, based on fDi intelligence data (2016).

Figure 2.4. FDI inflows through M&A in the Asia-Pacific region, 2009-2015

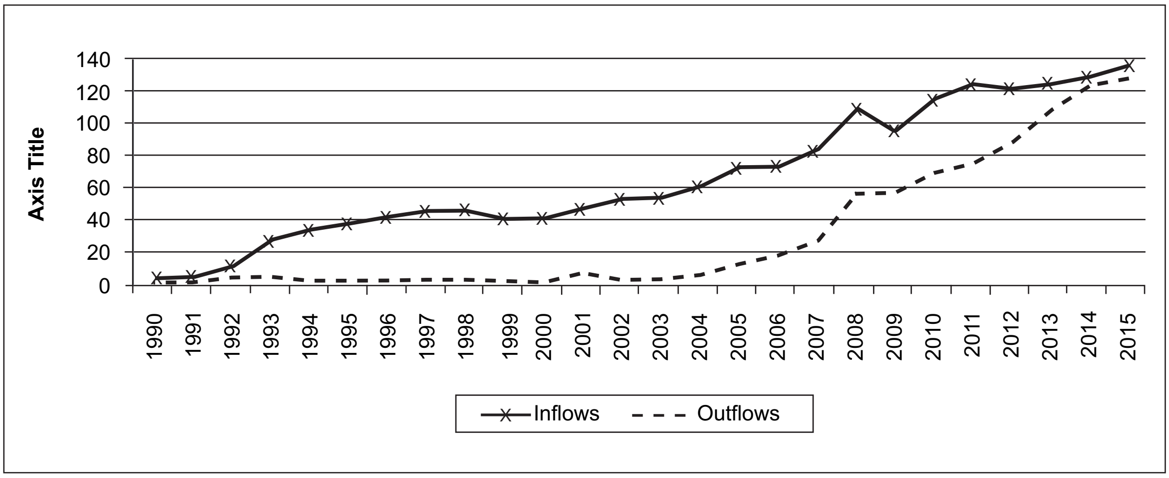


Source: ESCAP calculations, based on UNCTAD (2016).

Many Asia-Pacific developing countries, in realizing the benefits of FDI, have improved their investment environment by adopting and implementing national and regional investment measures addressing liberalization, facilitation and promotion of FDI. This is also reflected by the recent accession to WTO of various least developed and landlocked developing countries of the region (e.g. Afghanistan, Kazakhstan, Kyrgyzstan, Lao People's Democratic Republic, Mongolia) while others are still in the process of accession, sending positive signals to foreign investors. These developments have encouraged companies to set up production networks, where production processes are distributed to different countries and suppliers.

Among all subregions of Asia-Pacific,[14] East and North-East Asia and South-East Asia have attracted the most FDI, as countries liberalized their economy and have continued to improve their business and investment climate. FDI has been mostly attracted in labour-intensive sectors such as manufacturing of textiles, clothing and electronics, with some emerging economies managing to attract FDI in higher value-added and high-tech sectors. Strategic asset-seeking FDI and FDI in services have targeted countries such as India, Malaysia and Singapore (ESCAP, 2015). Since the early 1990s, FDI in China has increased tremendously, and in 2014, surpassed the United States in total FDI inflows (although in 2015, the United States again was in the leading position, with a tremendous surge in M&As) (figure 2.5. and table 2.1.). Until recently, most FDI to China was in the form of efficiency-seeking FDI exploiting low-cost labour to produce labour-intensive final consumer products for exports based on assembling parts and components imported from other part of the world, including Asia (hence, China is known as "Factory Asia"[15]).

Figure 2.5. FDI inflows to China, 1990-2015



Source: ESCAP calculations, based on UNCTADstat (2016).

Recently the country has lost its labour cost competitive advantage as wages have risen, but as labour productivity has also risen combined with its excellent infrastructure and effective participation in global value chains, China has managed to attract FDI in more capital- and technology-intensive sectors and supply chains, sustaining high inflows of FDI and making it a prime example of how to use FDI for development. At the same time, China has emerged as a leading outward investor, originally focusing on resource-seeking FDI, including in smaller economies in the Asia-Pacific region, but increasingly on strategic-asset seeking FDI (M&As) targeting access to technologies and skills in higher developed countries. In addition, the country's growing middle class clearly attracts market-seeking FDI as well. Production networks have spread to other countries in the region, increasing intraregional trade and attracting more FDI to these countries. Following in the footsteps of China, the most recent success stories in terms of FDI are Indonesia and Viet Nam (box 2.2).

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[14] ESCAP distinguishes the following subregions: East and North-East Asia, South-East Asia, South and South-West Asia (including Islamic Republic of Iran), North and Central Asia (including Mongolia), and the Pacific.

[15] As ADB (2013) concludes, "Factory Asia refers to the model of regional production networks connecting factories in different Asian economies, producing parts and components that are then assembled, with the final product shipped largely to advanced economies (Ando and Kimura, 2005)".

Regionally, however, FDI remains concentrated in a few countries. For example, FDI inflows to least developed and landlocked developing countries remain low (table 2.1). LDCs in the Asia-Pacific region account for less than 1.5% of total regional FDI inflows despite the steady increase during the past decade. These countries have often attracted FDI in the natural resources sector, which can pose additional challenges in the management of investment revenues and resources. LDCs such as Bangladesh and Cambodia rely on FDI in labour-intensive industries such as textiles and garments which dominate their economies. Detailed reviews of trends in FDI both globally and regionally can be obtained from the UNCTAD World Investment Reports at the following website: **http://unctad.org/en/pages/DIAE/World%20Investment%20Report/WIR-Series.aspx.**

In addition, ESCAP's Asia-Pacific Trade and Investment Reports also provide a regional overview and analysis of FDI inflows and outflows. The reports can be accessed at:**http://www.unescap.org/publications/asia-pacific-trade-investment-report.**

Table 2.1. FDI inflows to Asian-Pacific economies by subregion, various years (in millions of United States dollars)

Subregion/Economy	1990	2000	2005	2010	2015
East and North-East Asia	**9 619**	**115 193**	**124 306**	**199 836**	**317 479**
China	3 487	40 715	72 406	114 734	135 610
DPR Korea	5	11	-6	14	83
Hong Kong, China	3 275	54 582	34 058	72 319	174 892
Japan	1 806	8 323	2 776	- 1 252	2 250
Macao, China	0	- 1	1 243	2 831	3 907
Mongolia	0	54	185	1 691	195
Republic of Korea	1 046	11 509	13 643	9 497	5 042
South-East Asia	**12 821**	**22 515**	**43 113**	**105 572**	**125 732**
Brunei Darussalam	7	550	289	481	173
Cambodia	0	149	381	1 342	1 701
Indonesia	1 092	-4 550	8 336	13 771	15 508
Lao PDR	6	34	28	279	1 220
Malaysia	2 611	3 788	4 065	9 060	11 122
Myanmar	225	91	110	6 669	2 824
Philippines	550	2 240	1 854	1 298	5 234
Singapore	5 575	15 515	18 090	55 076	65 262
Thailand	2 575	3 410	8 004	14 568	10 845
Timor-Leste	...	...	1	29	43
Viet Nam	180	1 289	1 954	8 000	11 800
South and South-West Asia	**897**	**5 848**	**24 213**	**44 155**	**66 993**
Afghanistan	0	0	271	211	58
Bangladesh	3	579	845	913	2 235
Bhutan	2	0	6	76	12
India	237	3 588	7 622	27 417	44 208
Iran (Islamic Rep. of)	- 362	194	2 889	3 649	2 050
Maldives	6	22	73	216	324
Nepal	6	0	2	87	51
Pakistan	278	309	2 201	2 022	865
Sri Lanka	43	175	272	478	681
Turkey	684	982	10 031	9 086	16 508

Table 2.1. *(continued)*

Subregion/Economy	1990	2000	2005	2010	2015
Central Asia	**...**	**4 526**	**19 440**	**50,905**	**25 383**
Armenia	...	104	292	529	181
Azerbaijan	...	130	1 680	563	4 048
Georgia	...	131	453	814	1 350
Kazakhstan	...	1 283	1 971	11 551	4 021
Kyrgyzstan	...	- 2	43	438	404
Russian Federation	...	2 651	14 375	31 668	9 825
Tajikistan	...	24	16	74	227
Turkmenistan	...	131	418	3 632	4 258
Uzbekistan	...	75	192	1 636	1 068
Pacific islands	**9 891**	**15 837**	**-26 503**	**38 616**	**23 565**
American Samoa	...	...	...	...	...
Australia	7 904	14 191	-28 294	36 443	22 264
Cook Islands	0	59	6	0	1
Fiji	84	3	185	350	332
French Polynesia	22	2	8	64	83
Guam	...	...	...	...	...
Kiribati	0	1	3	-7	2
Marshall Islands	0	126	297	89	54
Micronesia (F.S.)	0	0	0	1	1
Nauru	1	1	1	0	0
New Caledonia	0	- 41	- 7	1 439	1 879
New Zealand	1 685	1 347	1 205	-62	-986
Niue	0	5	0	0	0
Northern Mariana Islands	7	2	- 8	15	0
Palau	1	3	4	3	-9
Papua New Guinea	155	98	34	29	-28
Samoa	7	- 1	4	0	16
Solomon Islands	10	13	19	25	13
Tonga	0	9	13	25	13
Tuvalu	...	...	...	1	1
Vanuatu	13	20	28	60	29
LLDC	**14**	**1 597**	**3 133**	**19 674**	**11 516**
LDC	**266**	**886**	**1 694**	**9 825**	**8 197**

Source: ESCAP statistical database. Available from **http://www.unescap.org/stat/data.**

Box 2.2. Rising FDI inflows to Indonesia and Viet Nam

Though Singapore continues to be the main destination for FDI in ASEAN, accounting for more than half of total ASEAN FDI inflows in 2015, Indonesia and Viet Nam have emerged as high growth markets for FDI. FDI inflows to Indonesia rose from just below $8.3 billion in 2005 to $15.5 billion in 2015 according to UNCTAD data, 1.4 times the amount received in Malaysia. In Indonesia, the main attractions are the country's abundant natural resources and huge market potential of a population of 250 million people. The introduction of Investment Law No. 25 in 2007 was the cornerstone of the rapid rise in FDI inflows in Indonesia, which was relatively little affected by the 2008 global economic crisis. The law aimed at providing increased assurance on issues such as equal treatment among investors, repatriation of profit, investment incentives, and protection from nationalization in a bid to boost the investment climate in the country. Indonesia also benefited after Fitch and Moody's raised the country's sovereign credit rating to investment grade. Under President Joko Widodo, the country has continued its reforms, cutting fuel subsidies, addressing budget deficits and deregulating manufacturing, trade and agriculture, including reducing the negative list for FDI and increasing tax incentives for investment in "pioneer" industries such as energy, telecommunications, maritime transport and agricultural processing. However, infrastructural bottlenecks, high transport costs, persistent corruption, a rise in wages and export taxes on commodities may undermine the recent FDI success and send strong signals to the Government that reforms require a long-term strategy.

Viet Nam has also witnessed rapid growth in FDI inflows which reached $11.8 billion growth in 2015 according to reports released by the Ministry of Planning and Investment.[16] Foreign firms expanding in Viet Nam include Samsung, LG, Microsoft and Intel. The Government has continued systematic reforms, including improving the legal environment for FDI and the banking system and capital markets while making the currency freely convertible. It has promoted FDI in labour-intensive industries on the basis of low labour costs and generous incentives. In particular, the country has positioned itself as a low-cost manufacturing alternative to China, especially for cell phones, televisions, other electronics, footwear and garments. Viet Nam's membership of the Trans-Pacific Partnership (TPP) was expected to further strengthen the country's attraction for FDI until the United States withdrawal, which put the current status of the TPP in doubt. However, ongoing concerns with corruption and sustainability as well as the country's limited capability to conform to the stringent standards contained in TPP, including those on IPR, may put some brakes on FDI inflows. Low commodity prices and rising public debt are other concerns.

Source: ESCAP research.

2. Changing global characteristics of foreign direct investment and TNCs

Both globally and regionally, the characteristics of FDI and TNCs have undergone some changes which policy makers should take note of, in particular:

- **Worldwide sourcing/supply chain management** – Along with market-seeking FDI, efficiency-seeking FDI has been an important type of FDI worldwide, in particular in East and South-East Asia. Globalization and trade and investment liberalization, coupled with ICT developments, have allowed companies to source worldwide for parts and components and other resources as part of the production process. This has given rise to the emergence of global value chains (GVCs) (see box 2.3).
- **Global market presence essential** – Because of the rise of GVCs, for many larger TNCs global market presence has become essential. In addition, with crumbling barriers to trade and investment and increasingly sophisticated ICT tools, market-oriented FDI has also spread across the world as TNCs need to be close to customers and cater better to specific local demand through their subsidiaries or affiliates.
- **Cost minimization and intensive use of ICT/automation** – Worldwide sourcing and supply chain management are closely linked with cost minimization. As the world has become a battleground for TNCs, competition has been defined by lower costs and higher quality. ICT has played an important role in cost minimization and greater efficiencies in production and customer care.
- **Customized end-products** – With increasingly sophisticated demand, TNCs find that they cannot always sell the same product in different markets. With global presence, market segmentation and product differentiation to cater to different tastes and trends in individual countries has become essential.

[16] Available from **http://cvdvn.net/2015/09/27/vietnams-fdi-inflow-hits-record-high-so-far-in-2015**.

- **FDI in manufacturing and assembly is primarily flowing to more advanced middle- and high-skilled sectors** and not to lowest-skill, lowest-wage activities in the developing world, such as garments and footwear, and this trend is speeding up. According to a study by Moran (2015), the flow of manufacturing FDI to medium-skilled activities such as transportation equipment, industrial machinery, electronics and electrical products, scientific instruments, medical devices, chemicals, rubber, and plastic products was nearly 10 times larger per year in the most recent period for which data are available than the flow to low-skilled, labour-intensive operations, and has been speeding up over time. The ratio between higher and lower skill-intensive activities was roughly five times larger in the period 1990-1992, and reached approximately 14 times larger in the period 2005-2007.
- **Intangible assets (brands, skills, innovation) more important than tangible assets (factories, warehouses, dealer networks)** – The most successful TNCs are those that have developed brand name recognition (Quelch, 1999; Holt and others, 2004). People don't buy computers or smartphones but they buy an Apple iPhone or Samsung Galaxy. They don't buy a car but rather a Mercedes, Ferrari, Toyota or a Mini Cooper. Brands distinguish similar products on specific characteristics which allow for customized end products and customer care. Brands that have been most successful in continuous innovation have been the most successful overall, but such success is normally not sustainable in the long run. Today, even the most recognized brands such as Sony, Nokia, and even Microsoft are struggling with emerging competition.
- **Increasing importance of SMEs as TNCs** (see e.g. Fujita, 1995 and trend analysis reports of fDi markets[17]) – With the spread of TNCs worldwide as noted above, their suppliers often follow them (e.g. the electronics industry in Penang, Malaysia and automobile industry in Thailand). While such suppliers may have development benefits (in terms of potential skill and technology spill-overs, capital and employment) and should therefore be actively promoted; see e.g. Moran and others, 2016), they also may pose competition with SMEs in the host country which are often not in a position to cater to the demands of the parent company. Host countries must balance the positive impacts of foreign SMEs in terms of employment generation and production of quality products vs. the potential for crowding out of domestic SMEs. Many countries are adopting programmes that would raise the competitiveness of domestic SMEs in terms of efficiency, technology, compliance with global standards, labour skills and aim to integrate their domestic SMEs with global or regional value chains.
- **Increasing importance of emerging economies as outward investors** – Traditionally, FDI emanated from developed countries such as Europe, Japan and the United States. Increasingly, emerging economies such as the BRICS (Brazil, Russian Federation, India, China, South Africa) and others such as the Republic of Korea, Thailand and Taiwan Province of China have increased or are increasing their outward FDI. Host countries of FDI should be fully aware of the potential benefits of South-South FDI as well as the potential costs of such FDI in terms of contribution to sustainable development (Aykut and Goldstein, 2007). Increasingly, companies from emerging developing countries use outward FDI in the form of M&As to gain access to superior technologies and intangible assets.
- **Increase of state-owned enterprises (SOEs) and sovereign wealth funds (SWFs) as foreign investors** – With the increasing foreign reserves of various countries of the region, notably China, the importance of SWFs as foreign investors has increased, in particular in the development of infrastructure projects such as special economic zones.[18] According to UNCTAD (2015), FDI by SWFs more than doubled in 2014. However, the value of their FDI has been marginal compared with the value of assets under their management. In addition, SOEs from countries such as China have increased their outward FDI, often under protection from the home government (Gestrin, 2014). This has given rise to concerns of national sovereignty of national resources in host countries, though such concerns are sometimes exaggerated. In particular, investment from SWFs has been cut back in the wake of a collapse of international commodity prices, and the implementation of announced big investment projects by SWFs often does not happen. Hence, the role of SWFs in FDI is likely to remain small, while that of SOEs will be highly volatile, varying from marginal at times to important at others (Ramamurti, 2011).

[17] The trend analyses of fDi markets by country and sector show variations in the size of TNCs engaging in FDI by source country. Most FDI from countries such as China and Japan results from large TNCs while FDI from various Western developed countries, including the United States, show a more even distribution between large and smaller companies. See **https://www.fdimarkets.com/explore**.

[18] See e.g**. http://voices.mckinseyonsociety.com/sovereign-wealth-funds**.

- The importance of **Information and communication technology (ICT) TNCs** in international production has increased dramatically in recent years. According to UNCTAD data, between 2010 and 2015, the assets of these TNCs increased by 65% and their operating revenues and employees by about 30%, against flat trends for other top TNCs. The importance of **digital TNCs** – including internet platforms, e-commerce and digital content firms – is also growing rapidly (UNCTAD, 2017).

Box 2.3. The rise of global value chains

The term "global value chains" (GVC) has been used to describe the sequence of all functional activities required in the process of value creation involving more than one country (UNCTAD, 2013). According to UNCTAD (2013), "about 60% of global trade, which today amounts to more than $20 trillion, consists of trade in intermediate goods and services that are incorporated at various stages in the production process of goods and services for final consumption."

GVCs will become increasingly influential in determining future trade and FDI patterns as well as growth opportunities. Experience from the Asia-Pacific region shows that the benefits from participation in GVCs are multi-layered, ranging from the company level where GVCs can bolster productivity of participating enterprises and provide opportunities for creation of high(er)-skilled and better paid jobs, to the macro level with enhanced economic growth and higher per capita income. Most ASEAN countries owe their development to effective participation in GVCs which has in turn contributed to deeper subregional connectivity and integration among ASEAN member States (ASEAN Secretariat and UNCTAD, 2014). An effective development strategy will now require policy approaches to effectively facilitate dynamic insertion of local companies into GVCs.

Although the nature of GVCs may be sector-specific, they typically involve the movement of intermediate goods through successive countries within the global network system of TNCs. The global production strategies of TNCs, including outsourcing and offshoring[19], result in shifting the focus of global trade from trade in final consumer items (goods and services) to trade in intermediate inputs.

Source: ESCAP (2015).

3. Relationship between foreign direct investment and international trade

The rapid rise of inward FDI is directly linked to the rise of trade, both globally and regionally. The link between trade and FDI has been extensively discussed in the literature (Fontagné, 1999; Forte, 2004; Chaisrisawatsuk, 2007).[20] FDI can act as both a substitute and complement for trade:

- **Substitute:** when a firm decides to invest and produce in a foreign country to serve customers directly (or jump trade barriers) in that country rather than through exports. In that case, FDI may still have an impact on imports of required inputs not available in the host country.
- **Complementary**: when efficiency-seeking (export-oriented) firms look for the best location from which to produce and export their products.

Until recently, various countries still protected many industries from foreign ownership and investment, and investment promotion was consequently not considered as a priority for government policy. As trade barriers have fallen over the past three decades in most parts of the world and as intra-firm trade between countries has increased, a strong relationship has been observed between foreign trade and FDI flows, including in the Asia-Pacific region. As a result, FDI has moved from a substitute to a complement to trade. The surge in FDI flows and the liberalization of the world economy has turned investment promotion into an important development policy instrument. At the same time, trade policy has become increasingly important for investment promotion (UNCTAD, 2009). Generally, the more open a country is to trade, the more attractive it becomes for FDI. This is particularly evidenced by the (efficiency-seeking type of) FDI-led expansion of GVCs which, in turn, have facilitated intraregional, intra-industry and intra-firm trade (ESCAP, 2015). According to UNCTAD (2013), the ratio between global FDI stock and trade has almost doubled from around 50% in the mid-1990s to more than 100% in 2010.[21]

[19] Offshoring usually refers to the operations undertaken within the TNC in its foreign subsidiaries, while outsourcing normally refers to the subcontracting of a key function or operation of the TNC to an independent company abroad.

[20] For a theoretical overview of the relationship between FDI and international trade, see also **http://www.standrews.ac.uk/business/distance/Economics/Reading/Critique_trade_theories.pdf.**

[21] This ratio has to be interpreted with care as it mixes a flow variable (trade) with a stock variable (FDI). Therefore, as time goes by, the numerator (FDI) may increase not only because of greater FDI activity, but also because of the revalorization of FDI assets.

UNCTAD estimates that around 80% of global trade (in terms of gross exports) is linked to the international production networks of TNCs (either as intra-firm trade, contract manufacturing, licensing or franchising), or through arm's length transactions involving at least one TNC. In general, the rise of GVCs is linked in particular to greater efficiency-seeking FDI, through which TNCs seek to locate discrete parts of their production process in low-cost locations. Efficiency-seeking FDI increases the amount of trade taking place within the international production networks of TNCs.

In the absence of a multilateral regulatory framework on investment, the international regulatory framework for trade also has implications for investment and is being shaped at three levels (see also chapter 4, section C).

At the *global level*, the multilateral trading system under the World Trade Organization (WTO) provides a universal, rule-based system governing global trade. The relationship between trade and investment is recognized under various multilateral trade agreements that refer to FDI. For instance, the Agreement on Trade-Related Investment Measures (TRIMS) contains various provisions that prohibit performance requirements on foreign investors which are contingent on export performance, while FDI is recognized as a mode of trade in services under the General Agreement on Trade in Services (GATS). However, WTO members did not agree to include FDI as an additional area for negotiations though a working group under WTO analyses the interlinkages of FDI and trade.

At the *regional level*, the proliferation of regional integration arrangements (RIAs) or regional trade agreements (RTAs) alongside the multilateral trading system, is noteworthy (box 2.4).[22] RIAs are often politically motivated but are also formed to promote trade and investment among member countries, in particular as multilateral trade negotiations under the WTO have come to a halt. The increase of RIAs, especially since the mid-1990s, has had significant effects on the global distribution of trade flows and FDI. Common forms of RIAs are regional or bilateral preferential or "free" trade agreements, customs unions,[23] common markets, economic unions, economic partnership agreements etc. Recently, RIAs tend to be broad-based economic partnership agreements with commitments on services, intellectual property rights, investment, competition policy, environment and other areas of economic areas. In addition, ambitious "mega-regional" agreements, which include investment provisions, are being discussed or have been signed, i.e. the Trans-Pacific Partnership (TPP) and Regional Comprehensive Economic Partnership (RCEP) agreements. Hopefully, these agreements would address some of the complexities resulting from the current interwoven bilateral trade and investment agreements (ESCAP, 2015).

Box 2.4. The proliferation of international agreements with investment provisions

As of January 2016, there were 172 regional trade agreements in force or under negotiation involving an ESCAP member State, out of which 49 had investment provisions. At the same time, ESCAP member States are party to close to 1,500 international investment agreements accounting for 50% of the total number of IIAs globally. The growth in the number of these agreements has been rapid but has shown a decline in recent years. Most of IIAs are still in the form of bilateral investment treaties but increasingly wider scope agreements are signed which have investment provisions, most recently the Australia-Japan Economic Partnership Agreement, Australia-Republic of Korea free trade agreement, Japan-Mongolia Economic Partnership Agreement, Treaty on the Eurasian Economic Union and the Agreement and the Agreement on Investment under the Framework Agreement on Comprehensive Economic Cooperation between ASEAN and India. The conclusion of the Trans-Pacific Partnership Agreement probably has the most far-reaching provisions on investment but its implementation is in doubt after the United States withdrew from the Agreement in early 2017.

Source: Asia-Pacific Trade and Investment Agreements Database (APTIAD) and UNCTAD (2015).

22 While the term regional trade agreement is widely used, regional integration arrangements would cover wider forms of economic cooperation arrangements covering trade as well as other areas of economic cooperation. In particular, there has been a rise in the number of economic partnerships agreements (EPAs) concluded among two or more countries, including in the Asia-Pacific region. RIAs or RTAs include so-called free trade agreements (FTAs) which are more commonly preferential trade agreements (PTAs).

23 A customs union is a free trade area with free trade or relatively low tariffs on trade among the member of the customs union but with a common external tariff. Under a standard free trade agreement (FTA), the members of the FTA continue to impose their own external tariff on imports from non-members.

At the *national level*, the regulatory framework for trade and investment needs to conform to international commitments but remains the most important for foreign investors and exporters alike. Although some form of overall economic policy coordination mechanism is in place in all countries, the extent to which trade and investment policies are actually coordinated, and the extent to which they are developed through inclusive consultations, often remains unclear (ESCAP, 2007; Duval, 2008).

B. IMPACTS OF FOREIGN DIRECT INVESTMENT ON HOME AND HOST COUNTRY DEVELOPMENT

FDI has impacts on both home and host countries and the nature and extent of these impacts have been analysed extensively. Impact analysis can be done at multiple levels, i.e. at the firm level, sector level and level of the state, province, municipality or the national economy. Impacts may also differ by form and type of FDI, origin of the investor and destination of the investment. For instance, the impact of particular FDI project in one location may be different from the impact of a similar project in another location. Increasing levels of automation and use of other advanced technologies in investment projects also lead to different impacts, with some positive and some negative. An investment project with a high level of automation would probably have a relatively high impact on productivity but low impact on employment creation. Moran and others (2016) argue that for any reasonable analysis of the impact of foreign direct on emerging market economies, FDI flows must be divided into at least five separate industry segments, each with distinctive policy and regulatory challenges: FDI in (1) extractive industries; (2) low-skill (low-wage) manufacturing industries; (3) middle-to high-skill industries; (4) infrastructure; and (5) services. Net impact therefore depends on the policy objectives of a particular country, sector (defined by various criteria) or location. Clearly, with so many different variables and aspects to deal with, some level of aggregation is in order. This section seeks to summarize the main impacts on selected aggregate economic, environmental and social indicators as revealed by the academic literature, as a more detailed analysis goes beyond the scope of this publication. The focus is on analysing the impact of FDI on host countries as this handbook is mostly concerned with promoting and facilitating inward FDI.

1. Impact on home countries

With regard to the impact of FDI on the home country, traditionally outward FDI has been promoted as it increases the international competitiveness of domestic companies that invest abroad and makes it easier for those companies to access foreign markets and increase profits (see e.g. Sauvant and others, 2014). Home countries would benefit from income streams generated by FDI that are repatriated. FDI may also be used as a vehicle to access foreign technologies and skills or resources that are not available in the home market though the evidence of a positive impact on total factor productivity in the home country is mixed.

On the downside, FDI has been blamed for exporting jobs abroad as labour costs rise in the home market. However, there is no strong evidence for this assertion (Lipsey, 2002). Agarwal (1996) argues that the extent that outward FDI would result in job loss in the home market really depends on the type of FDI. In particular, resource-seeking and market-seeking FDI should result in net job growth as there are employment benefits associated with additional exports of capital equipment, intermediate goods and new product lines to foreign affiliates, and the need for more office jobs in the home countries. Efficiency-seeking FDI may cause more unemployment due to export substitution and reimports than employment through additional exports to host countries. In other words, as wages rise in the home market and labour-intensive production processes are outsourced to other countries through FDI, the impact on home country employment may be negative. This seems to be supported by the academic literature although the impact has been generally mild (e.g. Kokko, 2006). Obviously, industries where countries are no longer internationally competitive need to be replaced by higher-end and more skill- and technology-intensive industries as part of the development process and governments need to adopt and implement policies to support that shift (e.g. Elia et. al, 2009).

More recent research by Hufbauer and others (2013) revealed that the expansion of foreign affiliates of United States TNCs was positively associated with more production, greater employment, higher exports, and more research and development (R&D) in the United States. These results draw on firm level data from 1990 through 2009, covering over 1,500 United States TNCs and their more than 10,000 affiliates. The analysis controlled for trends over time, thus isolating the relationship between FDI and domestic activities separate from the effects of aggregate growth rates and business cycles. It also controlled for the identity of the firm, thus removing any concerns about firm-specific drivers of these trends, such as how big the firm is or what type of

goods or services it produces. The results strongly suggest that the expansion of TNCs abroad is complemented by expansion of these TNCs at home.

To the extent that FDI replaces exports, the current account may be affected as exports decline while the capital account may suffer because of the capital outflow associated with FDI though this may be offset by repatriated earnings in the long run (Zhang, 2001). Kokko (2006) finds that outward FDI is beneficial to the investing firm, but that the effects on the home country vary depending on the characteristics of the investment project and the business environment in the home and host countries. On the whole, however, outward FDI is viewed positive though the net impact of outward FDI on the home country may differ according to the type, size and purpose of FDI.

2. Impact on host countries (developing countries): the economic dimension of sustainable development

Similarly, the impact of FDI on the host country is also mixed and not straightforward and is very dependent on government policy, attitudes towards FDI, the form, type and quality of FDI, and existing conditions in the host country at the time the investment is made, including its absorptive capacity. As Moran (2011) notes, "not only are the potential impacts of FDI varied and diverse, but host [country] efforts to secure those potential benefits (and avoid potential damage) require particular kinds of policies to improve market functioning, supply public goods, set standards, and overcome idiosyncratic types of market failure." He also notes that "the relationship between economic outcomes and governance and environmental outcomes is particularly close for FDI in extractive industries and infrastructure, but is often important for FDI in manufacturing and services as well." Depending on policy, the impact of FDI can be overwhelmingly positive or disastrous.

Before and just after World War II, FDI was viewed with suspicion as a tool for developed countries to wield influence over developing countries and exploit their natural resources and the impact of FDI was widely viewed negatively. However, with independence and the increasing international rule of law in trade and investment, FDI has been viewed more positively as a source of capital, skills, access to markets and technology. Generally speaking, the net positive impact of FDI is expected to be higher in host locations that have relatively higher absorptive capacity. Absorptive capacity is a country's or location's capacity or ability to absorb the benefits that FDI can offer. Absorptive capacity factors are factors that mediate FDI spillovers. Human capital, financial development, trade openness, quality of institutions and infrastructure, capacity of domestic firms, are all examples of absorptive capacity factors (see e.g. Nguyen and others 2009; Farole and Winkler, 2012; Khordagui and Saleh, 2013). Below follows a general description of the academic evidence of the impact of FDI on various economic, environmental and social indicators while recognizing that research is still ongoing with regard to the impact of specific types and forms of FDI.

(a) Impact on economic growth

Zhang (2001) finds that the impact of FDI on economic growth in the host country is higher in countries that adopt a liberalized trade regime, improve education and human capital, encourage export-oriented FDI and maintain macroeconomic stability. FDI also tends to have a higher positive impact in countries that have a high degree of good governance and rule of law (e.g. Olson, 2000; Globerman and Shapiro, 2002; Zhao et. al, 2003) and political stability (Morrissey and Udomkerdmongkol, 2012). As FDI constitutes a capital inflow, it appears that countries with better developed financial markets are better able to attract FDI (Alfaro and others, 2004). Azman-Saini and others (2010) also find a positive impact of FDI on growth only after financial market development exceeds a threshold level. In addition, a more developed financial system has been found to positively contribute to the process of technological diffusion associated with FDI (Hermes and Lensink, 2003). Within the context of India, Chakraborty and Nunnenkamp (2008) find that FDI has only led to output growth in the manufacturing sector but not in the primary sector. There may also be differences in impact whether FDI is in the form of greenfield investment or cross-border M&As (box 2.5).

Box 2.5. Which form of FDI has a higher impact on development: greenfield or M&As?

M&As have become much more prevalent in FDI inflows than greenfield investment in the Asia-Pacific region. This may raise cause for concern as greenfield investment involves investment in new production capacity and additional employment whereas in the case of M&As existing assets simply change ownership and the new company may actually result in net employment loss, in particular in cases where the acquired company is loss-making. Of course, on the positive side such as a loss-making company they may benefit from new management, fresh capital injections and as such may be rescued from bankruptcy. This happened in various Asian countries during and immediately after the Asian financial crisis of 1997. While some countries frowned upon the take-over of domestic assets by foreigners it was also realized that the alternative was bankruptcy and probably much wider unemployment.

The academic literature finds that both greenfield and M&As may result in economic growth under various conditions. For instance, Wang and Wong (2009) find that M&As only leads to economic growth if the host country has an adequate level of human capital. Lall (2002) takes an overall positive view of M&As though he notes that: “TNCs do not operate with full information, and wrong decisions on M&As can lead to high economic and social costs in host economies. The private interests of TNCs may diverge from the social interests of host economies: take-overs may lead to asset stripping, downgrading of local capabilities or the transfer abroad of scarce assets.” He also notes that M&As are not normally a feasible form of FDI in less and least developed countries where there is little interest to acquire foreign investors though in countries with economies in transition selected state-owned enterprises (SOEs) open to privatization may be potentially attractive. However, in more developed emerging economies, a merger or take-over can lead to higher efficiencies, employment retention, technology and skills transfer, expanded market access and better management. Indeed, in some emerging markets M&As and public-private partnerships have become the leading form of FDI.

Using panel data for up to 123 countries over the period from 2003 to 2011, Ashraf and others (2014) find that greenfield FDI has no statistically significant effect on total factor productivity (which is the main driver of economic growth in the long term) while M&As have a positive effect on total factor productivity in the total sample. However, in order to benefit from FDI-induced increases in productivity through technological spillovers, countries should not lag too far behind the technological frontier, i.e. have the absorptive capacity in terms of technological capacity to benefit from such investment. In other words, most developing countries would fall below the required threshold level of economic development to benefit from either M&As or greenfield FDI.

Theoretically, both forms of investment add to the financial resources of the host country although domestic companies could be sold at below asset value due to emergencies associated with financial crisis. Both forms can lead to technology transfer and upgrading depending on similar conditions. It should be noted that M&As are also used as a way by companies with lower technological capability acquiring companies with higher technological capability to access technology. As a result, M&As is a favoured form of outward FDI from companies in developing countries. Companies with higher technological capability are more likely to engage in greenfield investment.

In conclusion, the impact of either form of investment is inconclusive and is dependent on host country conditions, in particular countries’ absorptive capacity and other particular circumstances.

Source: References in text.

Romer (1992, 1994) notes the potential contribution of FDI to economic transformation in countries, in particular efforts of countries to move away from dependence on single commodities or labour-intensive industries. He notes that the contribution of FDI does not come so much in the form of productivity increases, technology transfer or capital inflows but rather in the form of *ideas* about new and more sophisticated activities. These ideas may already exist in more developed countries but can be introduced for use by developing countries also (box 2.6).[24]

Tiwari and Mutascu (2010) also find a positive correlation between FDI and economic growth in Asia based on panel data analysis but note that export-led growth is a better option than FDI-led growth. However, not all studies find a positive contribution of FDI to economic growth though most of these studies are rather old. For instance, Kosack and Tobin (2006) and Herzer and others (2008) find no significant relationship between FDI and improved economic growth or human development in poor countries. In fact, Herzer and others (2007) find no clear association between the growth impact of FDI on the one hand and the level of per capita income, the level of education, the degree of openness and the level of financial market development on the other hand in

[24] See also Moran (2011), p. 85.

Box 2.6. Contribution of FDI to economic transformation: the case of Mauritius

In analysing the contribution of FDI to ideas on economic transformation, Romer (1992,1994) cites the example of Mauritius, a small island-country that, upon independence in 1960 was almost completely dependent on agriculture, in particular sugar production. However, when the country started to actively court FDI in the garment industry, it witnessed rapid economic growth at higher levels than other countries in the region such as Sri Lanka. Mauritius built export processing zones to attract FDI and set up an active investment promotion agency. Romer notes that FDI did not contribute to savings to finance the investment in the EPZ. FDI also did not contribute to better access to technology as sewing machines were already widely available in the country and other machinery could be easily bought on international markets. However, FDI contributed by introducing an integrated package of "ideas" about how to run a modern garment factory, how to ensure quality, how to manage relations with textile importers in developed countries, and how to maneuver through the web of international trade quotas.

Romer's analysis is clearly dated and there is ample evidence of positive impacts of FDI on various economic variables. However, the contribution of FDI to specific ideas on economic management is noteworthy.

Source: Romer, 1992 and1994 as quoted in Moran, 2011.

developing countries. Carkovic and Levine (2002) also do not find a robust independent influence of FDI on growth.

Given the complex landscape that affects FDI's impact on economic performance, it is not clear to what extent it can act as a trigger for economic growth. Indeed, there is evidence that economic growth is as much a trigger for FDI inflows as FDI is a trigger for economic growth (e.g. Chowdhury and Mavrotas, 2006). This is mainly due to the fact that in the early stages of development, FDI is often attracted to a single industry or sector, often extractives or labour-intensive industry such as garments, with few opportunities for FDI to benefit the rest of the economy. This, in turn, is due to a lack of solid fundamentals (e.g. rule of law, skilled work force, etc.) in these countries. Once these fundamentals are in place, economic growth is more likely and the country becomes an increasingly attractive place to invest, leading to an increase in both domestic investment and FDI flows.

Academic research is always limited by data availability, imperfect modelling and associated assumptions. Studies may find different outcomes depending on the methodology and assumptions they adopt for analysis. Notwithstanding these outcomes, the actual and overall positive experience of the region with FDI in countries of the region that have actively promoted it should be noted. While it can be argued that FDI played a minor role in some countries such as Japan and the Republic of Korea, ASEAN countries such as Indonesia, Malaysia, Singapore, Thailand and Viet Nam have benefited enormously from FDI.

What is clear is that in today's globalized world characterized by FDI dominated global value chains, it is difficult to see how countries can develop rapidly without economic openness which includes liberal trade and investment regimes. However, it is important to underscore the fact that for FDI to have a positive contribution to development, a minimum level of development and local institutional capacity needs to be in place (Saggi, 2000). FDI by itself is no panacea for development but needs to be embedded in a wider policy framework.

(b) Impact on capital flows and stock and tax revenue

FDI is considered an important source of external capital and financing for development and has as such been recognized both by the United Nations Monterrey Consensus of the International Conference on Financing for Development (2002) and again by the United Nations Addis Ababa Action Agenda of the Third International Conference on Financing for Development (2015). FDI can close four important financing gaps (Todaro and Smith, 2015):

- Gap between domestic savings and investment (i.e. savings are insufficient to meet investment demand);
- Gap in the balance of payment: capital account (capital outflows are larger than capital inflows);
- Gaps in the balance of payment: current account (imports exceed exports);
- Gap between government expenditure and revenue (FDI contributes to tax income).

In practice, however, the contribution of FDI to financing is more complicated. There is certainly evidence that FDI contributes to closing the savings-investment gap and to gross capital formation (Sun, 2002). According to UNCTAD, over the past decade (2004-2014), FDI stock tripled in LDCs and Small Island developing States and quadrupled in landlocked developing countries.[25] However, it can also lead to a replacement of domestic investment rather than adding to it (through crowding out of domestic enterprises), i.e. the attraction of FDI should not lead to paying less attention to the importance of domestic investment in total investment (Agosin and Machado, 2005). UNCTAD also notes that FDI is a critical source of finance for developing countries, but policymakers need to pay due regard to minimizing risks and adopting policies that make FDI work for development (see chapter 3).[26]

With regard to balance of payment gaps, FDI is considered less volatile and footloose than other forms of external capital, in particular portfolio investment, and is less likely to flow out of countries in terms of crisis. Mallampally and Sauvant (1999) note that FDI flows in 1997 to the five most affected countries by the Asian 1997 financial crisis remained positive in all cases and declined only slightly for the group, whereas bank lending and portfolio equity investment flows declined sharply and even turned negative in 1997. However, the outflow of repatriated earnings by foreign investors may reduce the overall contribution of FDI to the overall availability of finance, while controls on such outflows are viewed as a major disincentive for FDI (Asiedu and Lien, 2003). With regard to trade, export-oriented FDI has greatly contributed to the export success of various East Asian countries, including most recently in China and Viet Nam. The contribution of export earnings to financing for development has been also recognized by the United Nations conferences on financing for development. The contribution of export earnings to the balance of payments is only mitigated by the import content of production of TNCs in host countries. The import content tends to be higher in small countries (OECD, 2011). In some cases, the export of key commodities and products from LDCs, such as garments in Bangladesh and Cambodia, has an import content of over 80%.[27] International legal provisions as contained for instance in the WTO Agreement on Trade-Related Investment Measures (TRIMS) prohibit local content and trade balancing requirements.

With regard to the contribution of FDI to tax revenue, this is often offset by generous fiscal and financial incentives which are mostly in the form of tax rebates or holidays. This effect tends to be higher when various countries compete for the same type of FDI. Investors may be inclined to favour high-tax host countries anyway if the tax money is used to improve the business climate in those countries, i.e. through the provision of much-needed infrastructure. In addition, as FDI is supposed to lead to employment generation, it would indirectly contribute to increased income tax returns. On the negative side, TNCs are known to reduce their tax burden by registering their parent company in tax havens and engaging in transfer pricing (box 2.7.). This leads to so-called "base erosion and profit shifting" which refers to the negative effects of TNCs' tax avoidance strategies on national tax bases. However, Dharmapala (2009) argues that "recent evidence suggests that tax havens tend to have stronger governance institutions than comparable non-haven countries. Most importantly, tax havens provide opportunities for tax planning by multinational corporations. It is often argued that tax havens erode the tax base of high-tax countries by attracting such corporate activity. However, while tax havens host a disproportionate fraction of the world's foreign direct investment (FDI), their existence need not make high-tax countries worse off. It is possible that, under certain conditions, the existence of tax havens can enhance efficiency and even mitigate tax competition. Indeed, corporate tax revenues in major capital-exporting countries have exhibited robust growth, despite substantial FDI flows to tax havens."

(c) Impact on employment, wages and skills

The impact of FDI on employment is clear in the area of labour-intensive industries exploiting low-cost labour (Nguyen and Dinh, 2015) and generally greenfield investment is more likely to result in employment generation than M&A as the latter could result in consolidating the new firm which could lead to cost-cutting and dismissals. Indirectly, FDI may increase the employment levels in local firms through forward and backward linkages in domestic production, though FDI also may crowd out inefficient domestic firms leading to loss of employment (Nguyen and Dinh, 2015). The impact of TNCs on women employment has been particularly impressive in the ready-made garment (RMG) industry in least developed countries such as Bangladesh and Cambodia although it should be noted that most of the employment was created by domestic enterprises

[25] UNCTAD, *Global Investment Trends Monitor*. No. 20. 5 June 2015. Available from **http://unctad.org/en/PublicationsLibrary/webdiaeia2015d3_en.pdf.**

[26] Ibid.

[27] See e.g. Available from **http://gain.fas.usda.gov/Recent%20GAIN%20Publications/Cotton%20and%20Products%20Annual_Dhaka_Bangladesh_7-31-2014.pdf.**

Box 2.7. TNCs, tax havens and transfer pricing

Tax havens allow TNCs to shift profits out of high tax jurisdictions into low tax jurisdictions most commonly via transfer pricing (see Eden 2009). Transfer pricing is the pricing of cross-border intra-firm transactions between related parties which can be manipulated through over- or under-invoicing of intra-firm transfers of goods, services or intangibles to exploit differences in corporate taxes imposed by different countries the TNC is doing business in. Transfer pricing is a well-known tactic used by TNCs to avoid or evade taxes or at least minimize the tax burden. In addition, TNCs can artificially shift profits from high-tax to low-tax jurisdictions using a variety of techniques, such as shifting debt to high-tax jurisdictions. Empirical studies such as Egger, Eggert and Winner (2010) confirm that TNCs pay little tax relative to their profits.

This conflicts with the TNC as a good corporate citizen and the need to implement responsible business practices. In a global economy where TNCs play a prominent role, governments need to ensure that the taxable profits of TNCs are not artificially shifted out of their jurisdiction and that the tax base reported by TNCs in their home country reflects the economic activity undertaken therein. For TNCs, it is essential to limit the risks of economic double taxation which is the reason for the existence of avoidance of double taxation treaties (DDTs) that are part of the realm of international investment agreements. However, in the case of transfer pricing, firms charge low prices for sales to low-tax affiliates but pay high prices for purchases from them. In many cases, overseas affiliates or subsidiaries only exist on paper. As a result, transfer pricing leads to under-reporting profits in countries with relatively high corporate tax rates and therefore is basically a case of tax evasion.[28] Tax havens facilitate the practice of transfer pricing. Transfer pricing is also made possible through prevailing tax loopholes, including the principle of “arm’s length.” The arm’s length principle states that transactions between different subsidiaries of multinational corporations have to be treated – for tax purposes – as if they had taken place between independent parties.

OECD’s Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations[29] provide guidance on the application of the “arm’s length principle” for the valuation, for tax purposes, of cross-border transactions between associated enterprises. They were originally approved by the OECD Council in 1995 but have since then undergone revisions, most recently in 2010. On 19 July 2013, the OECD published an Action Plan with recommendations to tackle corporate tax avoidance but these recommendations are not binding.[30] In 2015, the Group of 20 (G20) finance ministers expressed strong support for the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project, which provides governments with solutions for closing the gaps in existing international rules that allow corporate profits to “disappear” or be artificially shifted to low/no tax environments, where little or no economic activity takes place.[31] The project resulted in 15 actions that equip governments with domestic and international instruments to address tax avoidance, ensuring that profits are taxed where economic activities generating the profits are performed and where value is created. The actions can be accessed at: **http://www.oecd.org/ctp/beps-actions.htm.**

These actions finally culminated in the signing of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting by 70 countries on the 7th June 2017. The text of the Agreement (in English) can be accessed at **http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf**.

Source: OECD, references quoted in text.

exporting garments to well-known transnational brand-name retail corporations in developed countries rather than by these TNCs through FDI in the host countries. However, to the extent that FDI takes place in the garment sector, it was found that TNCs are on average 20% more productive than domestic firms, while statistical evidence suggests that productivity spill-over to domestic enterprises occurs (Kee, 2005). Moran (2011) points out that data consistently shows that foreign firms pay more than local firms, in particular in poorer countries. In a later study, Moran (2015) finds that foreign investors in middle-skill-intensive operations not only pay higher wages and offer more benefits to their employees than what is received by workers in low-skill-intensive plants, but they typically pay a wage premium in comparison to comparable indigenous firms. In assessing the employment effect of FDI in India, Someshu (2015) distinguishes the following possible impacts:

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28 The difference between tax avoidance and tax evasion is that the former is the legitimate minimizing of taxes through legal means while the latter refers to illegal practice of not paying taxes, by not reporting income, reporting expenses not legally allowed, or by not paying taxes owed.

29 Available from **http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-guidelines.htm.**

30 Available from **http://www.oecd.org/ctp/BEPSActionPlan.pdf.**

31 Available from **http://www.oecd.org/tax/g20-finance-ministers-endorse-reforms-to-the-international-tax-system-for-curbing-avoidance-by-multinational-enterprises.htm**.

- **Employment creation**: FDI brings new production capacity and new jobs. It can also improve the development of relevant industries.
- **Employment crowding-out**: FDI can lead to more intensive competition and due to superior assets and knowledge it may crowd out domestic enterprises while others may have had to reduce employment to improve their competitiveness.
- **Employment shift**: FDI can lead to cooperation between foreign and domestic companies, for instance in the form of joint ventures or vertical linkages which may lead to additional employment, mostly indirect.
- **Employment loss**: Foreign-invested enterprises may bring their own managers and workers as domestic workers do not have the required skills or other work requirements.

On balance, it is difficult to predict the net impact of FDI on employment. Most academic research finds a positive impact of FDI on employment (e.g. Fu and Balasubramanyam, 2005 for the case of China; Jayaraman and Singh, 2007 for the case of Fiji; Pinn and others, 2011 for the case of Malaysia; Someshu, 2015 for the case of the services sector in India) though some find negative impacts (e.g. Jenkins, 2006 for the case of Viet Nam). With ongoing automation and use of robots in production processes, the contribution of FDI to employment may further decline. Table 2.2 summarizes the potential direct and indirect effects of FDI on employment.

Table 2.2. Potential direct and indirect effects of inward FDI on host country employment conditions

	Direct		Indirect	
	Positive	**Negative**	**Positive**	**Negative**
Quantity	Adds to net capital and creates jobs in expanding industries.	Acquisitions may result in rationalization and job losses.	Create jobs through forward and backward linkages and multipliers effects in the local economy.	Reliance on imports or displacement of existing firms results in job loss.
Quality	Pays higher wages and has higher productivity.	Introduces practices in e.g. hiring and promotion that are considered undesirable.	Spillover of "best practice" work organization to domestic firms.	Erodes wage levels as domestic firms try to compete.
Location	Adds new and perhaps better jobs to areas with high levels of unemployment.	Crowds already congested urban areas and worsens regional imbalances.	Encourages migration of supplier firms to areas with available labour supply.	Displaces local producers, adding to regional unemployment, if foreign affiliates substitute for local production or rely on imports.

Source: UNCTAD (1994)

FDI may have a positive impact on labour productivity in recipient industries through the direct introduction of capital, technology and management skills and indirectly through spillover effects on domestic firms. There is indeed evidence that FDI contributes to higher labour productivity (e.g. Chang and Luh, 2000; Liu and others, 2000; Pham, 2008) though the link is not always strong (e.g. Zhang, 2001). However, conversely, low-cost labour alone is rarely an attraction and a minimum level of labour productivity (i.e. skills) is required for any form of FDI.[32] Thus, while FDI is often promoted to improve skills, it is often found that, rather, the availability of skills and good local education helps to promote FDI (Noorbakhsh and others, 2001). In such cases, FDI can also lead to higher relative wages of workers working for TNCs though FDI has not been found to significantly reduce wage inequalities in host countries (Velde and Morrissey, 2004). While the traditional presumption has been that TNCs pay higher wages and offer better working conditions than local enterprises, the actual evidence for this presumption is mixed. It depends to a large extent on the home country of the TNC (e.g. a Western country with strong responsible business sense) vs. TNCs from emerging developing countries that are less concerned with working conditions but are focused on international competitiveness. However, Western TNCs have also been associated with substandard working conditions in developing countries (e.g. the RMG industry in Bangladesh;[33]

32 See e.g. **http://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/856.pdf.**

33 See e.g. **http://www.cleanclothes.org/resources/publications/2012-11-hazardousworkplaces.pdf**, and **http://www.ilo.org/dhaka/Whatwedo/Projects/WCMS_240343/lang—en/index.htm.**

Foxconn in China[34]). OECD (2008a) finds a positive wage effect on workers that are directly employed by TNCs, while smaller positive impacts on wages are also found in domestic firms that are part of the supply chain established by TNCs. With regard to non-pay related working conditions, the evidence is more mixed. For instance, while working conditions in foreign firms tend to differ from those in comparable domestic firms, they do not necessarily improve following a foreign takeover.

TNCs often engage in FDI to avoid stringent social and environmental standards in the home country ("home-country standard"). In some cases, TNCs have also been accused of violating human and labour rights in developing countries where governments fail to enforce such rights effectively ("universal standard"). As a result, the social impact of TNCs in host countries should be assessed on the basis of a "local standard" (OECD, 2008b). This involves comparing the wages and working conditions of employees in the foreign affiliates of TNCs and their supplier firms to the wages and working conditions that they would have received had they not been employed by a foreign firm or one of its suppliers. The difference may be interpreted as the contribution of TNCs to improving wages and working conditions in the host country.

With regard to impact on skills, UNCTAD (2011b) finds that a national innovation system that encourages cooperation between local research institutions, foreign TNCs, and local firms can lead to higher levels of skill spill-overs. Box 2.8 describes the positive experiences with skills development through FDI in Viet Nam. Box 2.9 explores a best practice of skills development through FDI in Singapore.

Box 2.8. Skills development through FDI: the experience of Viet Nam

FDI inflows have played a central role in the transformation of the Vietnamese economy. In addition to higher economic growth and reduced poverty, this transformation has also led to increased demand for skilled labour. To address the labour market challenges associated with more technologically advanced and skills-intensive sectors, some foreign companies have instituted their own training programmes. For instance, in the electronics industry, Intel has been sending Vietnamese employees to other facilities in Asia as part of their hiring strategy, in order to give them training in a fully operational facility from experienced managers. The company has also begun to proactively address the issue of availability of skilled graduates by engaging in talks with United States universities about plans to establish campuses in Viet Nam. Foxconn recruited 500 university graduates in Viet Nam and sent them to China to prepare them for key staff positions.

The foreign investors involved in the Phu My 3 Power Plant have put in place a "localization plan" in which most positions in the company are turned over to local staff. In addition to being trained to use the computer system to run the plant, nationals are trained to address environmental issues, safety awareness and health issues affecting people working at the plant and also living in the surrounding community areas.

In agro-processing, Nestlé, one of the largest foreign investors in agriculture in Viet Nam, with the support of experts have developed a programme to work with Vietnamese coffee organizations and growers to improve coffee quality, with a focus on processing.

Source: UNCTAD (2011b)

Box 2.9. Skills development through FDI: The case of Singapore

Singapore represents a very successful model of FDI-related skill development. Tracing through its different stages of development, Singapore exemplifies a tight "coupling" between economic development strategies and skills development policies. During early industrialization, Singapore focused on developing basic primary and secondary education to complement its labour-intensive economy. As the country began to attract and rely on FDI in more capital-intensive and skill-intensive industries, education and training policy started focusing more on specific technical skills required by investors. Since the 1980s, the technical and vocational training system has been deepened, while the university system was reformed and expanded. Throughout the country's development, the Government of Singapore has targeted and leveraged the knowledge and technology of foreign investors to enhance domestic education and training efforts, including through the direct training of foreign affiliate employees and those of their local suppliers. As a result of these integrated skills, policies and their responsiveness to economic change, Singapore has developed one of the most highly qualified workforces in the world.

[34] See e.g. **http://www.termpaperwarehouse.com/essay-on/Workers-Exploitation-In-China/211240**, and **https://rdln.files.wordpress.com/2012/01/pun-ngai_chan-jenny_on-foxconn.pdf.**

Throughout its development, Singapore has tailored its education and worker training system according to broader economic objectives. This has been facilitated through multi-departmental and tripartite institutional arrangements to coordinate policies for skills development. Three institutions, in particular, are important. First, the high-level National Manpower Council (NMC) – like its predecessor, the Council for Professional and Technical Education (CPTE) – brings together the Ministry of Trade and Industry (MTI), the Ministry of Education (MOE), and the Ministry of Manpower (MOM) to jointly manage the supply of skills given current and estimated future demand. To accomplish this task, the NMC sets targets and coordinates with universities, polytechnics, institutes for technical education. Second, the MOE has formal jurisdiction over education and training institutions and is responsible for setting and implementing long-term human resource development plans. Finally, the Economic Development Board (EDB), in its role as an investment promotion agency under MTI, helps to identify and satisfy the short-term skill needs of foreign investors. These three government institutions, as well as the network of specific education and training institutions, benefit from interlocking board and council membership, ensuring a steady flow of information and encouraging a common approach to skill development. Moreover, the management of these institutions is often tripartite. The involvement of employers, labour unions, and public officials helps ensure that skills develop.

Source: UNCTAD (2011b)

(c) FDI and technology transfer

The role of FDI in transferring technology to developing countries is more complex and the evidence is also mixed. Conceptually, FDI can lead to technology transfer in three ways:

- Local firms may be able to learn simply by observing and imitating the TNCs;
- Employees may leave TNCs to create or join local firms;
- FDI may encourage the entry of international trade brokers, accounting firms, consultant companies, and other professional services, which then may become available to local firms as well (Blalock and Gertler, 2008).

Traditionally it seems logical that technology transfer is best achieved through the establishment of vertical and/or horizontal linkages (either through joint ventures or M&As) as long as such linkages are not imposed upon. Moran (2011) claims that data consistently show that “foreign investors transfer more technology and newer technology via wholly-owned (or at least majority-owned) affiliates than when they are required to operate as joint ventures.” However, in many cases, technology transfer, if it does take place at all, proceeds from the parent to a wholly-owned subsidiary and is therefore internalized and not diffused in the host country. Where it is necessary for a local affiliate or domestic enterprise that is part of the investor’s value chain to have access to the technology, technology may be transferred while demonstration effects may lead to positive spill-overs (Wahab and others, 2012).

Therefore, in practice, it is not so easy to transfer technology effectively. In many cases, the TNC either transfers outdated technology or is discouraged to transfer technology due to inadequate intellectual property rights protection or inability of local suppliers to absorb and effectively utilize the technology. For that reason, technology transfer to LDCs has been limited. On the positive side, with the rise of global value chains, TNCs may deliberately transfer technology to local suppliers as part of a strategy to build efficient supply chains for overseas operations and reduce costs of non-labour inputs (e.g. Javorcik, 2004). As the technology gets diffused, competition follows and prices drop benefiting the foreign investor (Pack and Saggi, 2001). While Rodrik (1999) observed that “the evidence for effective technology transfer by TNCs is sobering”, recent evidence shows once again the picture is very mixed and often depends on the host country’s absorptive capacity.

In recent years, with enhanced local capacity and national competitiveness in emerging markets, FDI can lead to technology transfer. For instance, in the specific context of Indonesia, Blalock and Gertler (2008) find that, first, vertical supply chains are a conduit for technology transfer from FDI in emerging markets and lead to productivity enhancement of local firms and, second, this technology generates welfare benefits that may warrant public policy intervention. They recommend therefore that governments should encourage FDI where there is potential for TNCs to source supplies from local suppliers. The success of horizontal technology transfer through joint ventures depends on the capability of the local joint venture partner and is also not guaranteed (see chapter 3 for a more elaborate discussion on linkages). Therefore, the transfer of technology through FDI is not automatic and requires governments to develop local technological capacity as demonstrated by the presence of solid education and vocational skills development centres, R&D centres and pro-active government policy towards the promotion of learning technical skills, providing the overall environment conducive to innovation and

protection of intellectual property rights (IPR) appropriate to the level of development (Lall, 2003). Lee and Tan (2006) also note the important role of the government. With regard to technology transfer through FDI in ASEAN, they find that Singapore has been the most successful. In particular, they note that in many instances, it was the speed, efficiency and flexibility of government that gave Singapore the competitive edge compared with other competing host countries examined. The level of IPR protection also seems to play an important role (see chapter 4). Box 2.10 describes positive experiences of Malaysia and Thailand in technology transfer through FDI.

Box 2.10. Technology transfer through FDI: the experiences of Malaysia and Thailand

Malaysia is a good example of successful vertical transfer of technology through FDI. Since the second half of the 20th century, the Government of Malaysia has encouraged foreign investors to invest in their industries and formulated specific industrial policies to attract TNCs in ever higher technology-intensive industries. Malaysia has managed to attract FDI for decades, even after the global economic crisis of the late 2000s. Since 2010, average annual FDI inflows has been over $10 billion, and accounted for around 10% of total FDI to ASEAN (cf. most inflows have been into Singapore, about 50% of total ASEAN FDI) (UNCTAD, 2014). A significant portion of such inflows has gone to the manufacturing sector, improving both the quantity and quality of domestic stock of capital goods and production facilities. The successful vertical transfer of technology in Malaysia's manufacturing sector led to the upgrade of machinery and product lines and increased production capabilities of local workers (Lee and Tan, 2006).

Thailand is another good example of using FDI to strengthen its R&D and human resource development. FDI has become a main source of technology transfer in Thailand. Since 2000, the automobile industry in Thailand has shifted towards more technology-intensive activities, including engineering (Poon and Sajarattanochote, 2010). One of the major causes of this shift was the expansion of Japanese investment in and technology transfer to Thailand (Techakanont, 2008). In the period 2005-2012, Japan has been the top investing country in Thailand investing $3 billion (35% of the total FDI inflows) per year on average (UNCTAD, 2014). Japanese automotive firms, such as Toyota and Honda, have established R&D centres in Thailand and have trained engineers and technicians (Yamauchi and others, 2009). Transferred technology from Japanese firms allow the Thai labour force to develop capacity in various areas, ranging from assembly, operating and maintenance to quality control technology. However, technology transfer in Thailand has been modest compared to Malaysia and Singapore, which have been more pro-active in implementing policies in education and skills development and developing local technological capabilities. In Thailand, science and technology policies remain rather fragmented (Poon and Sajarattanochote, 2010), while the lack of engineers and technological capabilities of Thai supplier firms has prevented Thailand from catching up with other more advanced ASEAN countries (Sadoi, 2010).

Source: references quoted in text.

It follows that LDCs with lacking skills and infrastructure, poor rule of law and high incidences of corruption, and underdeveloped financial sectors face challenges in attracting FDI and benefiting from it (UNCTAD, 2011a). Those that have abundant natural resources may be able to attract FDI but often fare badly due to a lack of good governance and the high incidence of corruption. In addition, FDI in natural resources is capital-intensive and does not generate much employment. Those countries are not able to attract market-seeking FDI as the purchasing power of the people is too small even if the size of the population is large. These countries may benefit from efficiency-seeking FDI looking for low-cost labour. It is well-known that labour-intensive FDI in countries such as Bangladesh and Cambodia (RMG industry) and China until recently has played a major role in employment and income generation and, hence, in reducing poverty. However, as noted above, FDI increasingly requires skilled or semi-skilled labour rather than unskilled labour.

Table 2.3 summarizes the general potential benefits and costs for the host country that are associated with FDI.

3. Impact on sustainable development in host countries: the social and environmental dimension

While under specific circumstances, the impact of FDI on economic development may be positive, the social and environmental dimensions of sustainability need to be carefully considered in an analysis of the impact of FDI. For instance, while FDI may lead to employment and increased tax revenue, negative externalities may prevail. As stated above, FDI inflows may not reduce income inequalities but may actually increase them. In addition, to the extent that FDI contributes to economic growth, this growth may be jobless and not inclusive. Furthermore, even when FDI contributes to economic growth, the negative externalities of FDI and investment

Table 2.3. Potential benefits and costs of FDI for the host country

Potential benefits	Potential costs	Comments
Capital inflows and financing for development.	Repatriated earnings.	FDI can close the savings-investment gap, budget gaps and balance-of-payment gaps but this is not guaranteed. The BoP effect depends on the trade effect of FDI and the extent of repatriated earnings. FDI can generate tax income which may be offset by overly generous tax incentives.
Employment generation.	Foreign companies can crowd out domestic companies.	The net effect of FDI on employment depends on a wide range of domestic policies and the sector in which FDI is attracted.
Skills generation.	Foreign companies can hire local skilled workers who may subsequently leave the country and lead to "brain drain".	Not only worker skills but also managerial skills can be transferred. Performance requirements may be useful in this regard but run the risk of discouraging FDI. Greenfield FDI has higher potential for employment generation than M&A which may lead to dismissals.
Technology transfer.	Transfer is not automatic and may be paid for.	Host countries are often not able to absorb foreign sophisticated technologies or get stuck with outdated technologies. Poor IPR regimes prevent effective technology transfer. For LDCs, technology transfer seldom takes place as those countries are most attractive to labour-intensive FDI and presence of strong IPR regime would make little difference in the absence of technological capabilities.
Competition.	Crowding out of local enterprises.	The entry of foreign companies can shake up a market by posing effective competition. Competition is an essential component of market economies and ensures efficient allocation of resources and business practice. However, superior knowledge and capital of TNCs may lead to crowding out of local enterprises. A comprehensive competition policy and law is called for to ensure that FDI does not lead to abuse of power.
Market access.	If host countries are party to specific regional trade agreements the preferential access gained may be ffset by restrictive rules of origin.	Efficiency-seeking and export-oriented FDI will make it easier for countries to access foreign markets.
Linkages with domestic firms.	Crowding out of domestic firms.	TNCs may link with domestic small and medium enterprises (SMEs) as suppliers raising their capacity and integrating them in global value chains. In the short-run, however, issues related to standard compliance and certification and overall competence of local suppliers is a concern. TNCs may attract SMEs as suppliers from their home country that may out-compete the local companies in the host country.

Table 2.3. *(continued)*

Potential benefits	Potential costs	Comments
Introduction of superior standards and development of local communities.	Social and environmental costs, e.g. displacement of local communities, labour exploitation, environmental pollution.	FDI by TNCs with a proven track record of responsible business practices, including those that engage in social investment have high development potential. For others, the rule of law must prevent social and environmental costs.

Source: ESCAP.

liberalization resulting from environmental degradation or substandard labour standards and working conditions and exploitation of child labour may offset the economic gains, while wages are kept at rock-bottom levels to maintain competitiveness (Fortanier and Maher, 2001). In particular, countries are often competing with each other to attract FDI. As a result, the use of incentives and relaxation of environmental and social regulation to attract FDI may result in a race to the bottom where the positive impacts of FDI on tax revenue may be offset and sustainability objectives may be comprised (e.g. Morisset, 2003; Abbas and others, 2012; Olney, 2013).

(a) Impact on poverty reduction

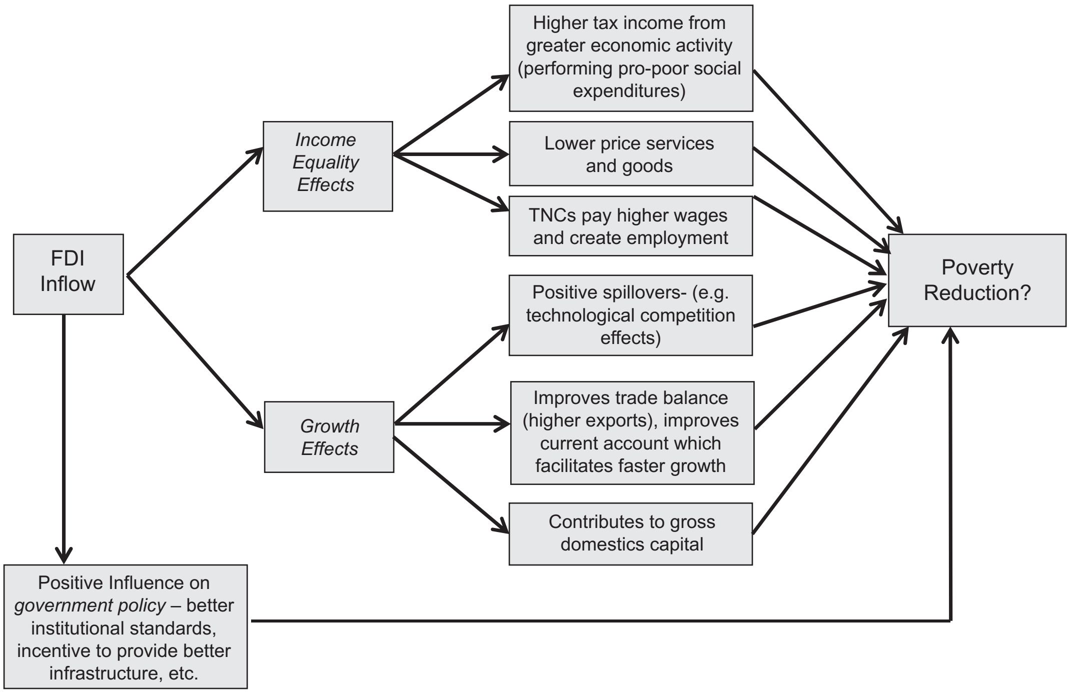
It is generally understood that FDI contributes to poverty reduction through the employment it generates and associated income generation. It is also understood that FDI generally leads to economic growth and that economic growth is an essential, if not sufficient, condition to reduce poverty. The actual experiences of various Asian and Pacific countries have demonstrated that trade and investment liberalization and overall economic openness have contributed to economic growth and poverty reduction (ESCAP, 2009). However, poverty remains an issue in the region and there is scope for making trade and investment more inclusive (ESCAP, 2013). Reports of workers abuse along the supply chains of various TNCs have also raised questions as to the impact of TNCs on inclusive development. The 2013 Rana Plaza disaster in Bangladesh was one of the most recent examples of substandard working conditions in the RMG supply chains dominated by TNCs even though the company producing garments was not a foreign-invested enterprise itself but produced for global brand name TNCs. It could also be argued that it was the Government of Bangladesh not enforcing the national building code.[35] As noted above, TNCs generally pay higher wages and offer better working conditions than local companies but this also depends on the home country of the TNC. TNCs from developing and emerging economies such as China have often received bad reports with regard to corporate responsibility but the tide seems to be slowly changing (box 2.11).

While FDI is known to contribute to the "growth enhancing" effect, its contribution to the "distribution effect" remains low. In this regard, various studies have not found a direct link between FDI and poverty reduction (e.g. Mold, 2004). Stiglitz (2002) also points out that TNCs often tend to abuse their market power and distort domestic policy choices in developing countries, keeping wages at rock-bottom levels and challenging development measures taken by governments as violating stability clauses in investment contracts or the provisions in bilateral investment agreements. But there are also positive reports of TNCs paying higher wages than domestic companies and paying higher wages in sectors that require higher skills (Moran, 2015).

In short, the impacts of FDI on poverty depend on many factors including the policies of the home countries of investors; host countries' social and labour laws and law enforcement, institutions and policies, the quality of the labour market, the economic environment, and the investment itself, in particular the practice of principles of corporate social responsibility (CSR) and responsible business practices by TNCs in their operations abroad. Figures 2.6 and 2.7 show two scenarios of possible impacts of FDI on poverty: one scenario highlighting positive effects and one scenario highlighting negative effects. In reality, the truth may lie in the middle.

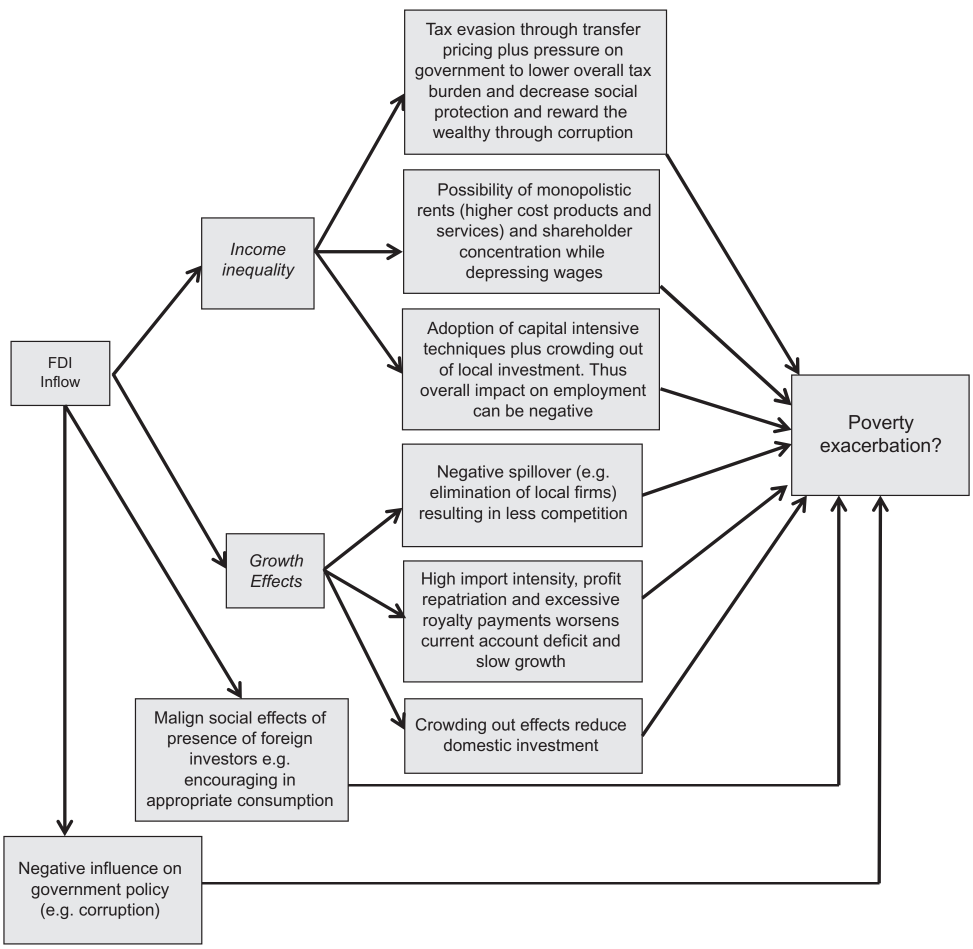
[35] Available from **http://www.economist.com/news/leaders/21577067-gruesome-accident-should-make-all-bosses-think-harder-about-what-behaving-responsibly**.

Figure 2.6. FDI and poverty reduction – positive effects



Source: Mold (2004).

Figure 2.7. FDI and poverty reduction – negative effects



Source: Mold (2004).

(b) Impact on environment

Similarly, the track record of the impact of FDI on the environment is mixed though the overall perception is that TNCs, given their economic importance in many developing host countries, often get away with pollution and other negative impacts on the environment, such as deforestation, loss of biodiversity and excessive greenhouse gas emissions. This is particularly the case in the mining and extractive sector. The debate on the impact of FDI on the environment has particularly focused on the claim or hypothesis that TNCs will move environmentally unsustainable practices to countries with relatively lax environmental laws and regulations, so-called "**pollution havens**." A WWF-UK report (Mabey and McNally, 1999) found indeed evidence for this hypothesis. It argues that "the economic growth produced by FDI is often fuelled at the expense of the natural and social environment, and the impact of FDI on host communities and countries is often mixed in environmentally sensitive sectors." Hitam and Borhan (2012) also find a positive correlation between FDI and environmental degradation in Malaysia. Based on a study conducted in China, Zhang and Fu (2008) find evidence that stringent environmental regulations have a significant and negative effect on FDI.

Cole and others (2006) find that TNCs can negatively affect a host country's environmental regulation depending on the level of corruptibility while Hoffmann and others (2005) link the effect of FDI on the environment to the host country's level of development. In other words, the higher the level of development, the less likely FDI will have a negative impact on the environment. This is probably due to the higher developed country's superior environmental laws and regulations. This seems to be supported by Merican and others (2007), analysing the impact of FDI on the environment in ASEAN countries. They find that FDI adds to pollution in Malaysia, Thailand, and the Philippines but not in Singapore while in Indonesia they find a negative correlation (though presumably they did not cover other environmental issues such as deforestation). Smarzynska and Wei (2001) find weak evidence for the pollution haven hypothesis.

On the other end of the spectrum of possible effects, Liang (2006) finds a positive effect of FDI on the environment in China. In particular, she finds evidence for the argument that trade and FDI could have a beneficial effect on a developing country's environment when the TNCs crowd out inefficient and polluting local firms, when they change the industry composition, and when they bring more efficient technology into the host country and improve productivity and energy efficiency. She also notes the income effect of FDI: when FDI brings employment and income growth, people might demand a higher environmental standard, more stringent environmental regulation and better enforcement by the government.

On balance, most studies have found no direct evidence for the pollution haven hypothesis. Evidently, it is easier to establish a link with FDI in particularly polluting industries such as mining and logging. On the other hand, as argued earlier, TNCs may bring superior technology and be cleaner overall than domestic companies. It also depends on whether the TNC's home country is developed and puts a lot of emphasis on the importance of environmental sustainability and holds its companies to account, including in their overseas operation, or whether the home country is an emerging economy which prioritizes economic growth over sustainability.

Box 2.11. Impact of Chinese FDI on sustainable development

China is not only known as the developing world's leading investment destination but also for its rapidly rising outward FDI. Motivated by the need to sustain export growth and manage the effects of the Asian 1997 financial crisis and helped by rapidly increasing foreign reserves, the Government has pursued its "going out" policy since the early 2000s, which has led to a sharp rise in Chinese outward FDI. Originally, the focus of Chinese outward FDI targeted natural resources and mining to fuel Chinese economic growth and resource-seeking FDI still figures prominently in total outward Chinese FDI. Chinese firms have coped better than Western companies with the global economic downturn, despite falling Chinese GDP. They are more resilient, partly because the Government of China maintains some level of control and protects both state- and privately-owned enterprises.

However, emerging practices worldwide suggest that Chinese investors hardly play by global norms, such as by observing good governance and social and environmental protection. It is partly because Chinese firms have little international experience and have unclear safeguards regarding their huge overseas investments that are often in energy and mining sectors. Chinese firms' foreign operations are more pragmatic, playing by the rules of host countries. This tends to exacerbate local conditions in countries with weak governance, human rights and environmental standards. This has been detected in the corruption and rent-seeking cases in Chinese extractive investments in Africa, violent conflicts with communities over a gas pipeline in Myanmar, and conflicts over pulp plantations and petroleum production in Indonesia.

However, the tide seems to be changing. Some Chinese companies are striving to practise responsible behaviour. A report by the Extractive Industries Transparency Initiative (EITI) international secretariat shows that Chinese firms operating in EITI-implementing counties are becoming as transparent as other companies. In a number of African and Asian countries, including Mongolia, a majority of Chinese companies began disclosing some information on their beneficial or real owners.

The Government of China has also issued Guidelines for Social Responsibility in Outbound Mining Operations. The guidelines lay out standards on labour and environmental protection, supply chain due diligence and community engagement. The need to incorporate elements of corporate social responsibility in other sectors is also slowly but steadily gaining recognition among Chinese investors.

As Chinese investment gradually abides by good international practices in the context of the ASEAN Economic Community, regional leaders and China can work together to foster a new Asian century that champions a culture of good governance and corporate accountability.

An excellent overview of the evolving impacts of Chinese FDI on the sustainable development of host countries is provided in an IISD survey (2016). The survey may be accessed at: **http://www.iisd.org/sites/default/files/publications/sustainability-impacts-chinese-outward-direct-investment-literature-review.pdf**.

Source: Available from **http://signin.nationmultimedia.com/opinion/Can-Asean-tame-the-wild-beast-of-China-investment 30278821.html#sthash.8sUzn4BY.dpuf.**

4. TNCs have a responsibility to contribute to sustainable development

It follows from the above analyses that governments need to implement appropriate policies and adopt the right regulatory framework to ensure an overall positive impact of FDI on development by optimizing the positive impacts and minimizing the negative impacts (Fortanier and Maher, 2001). FDI needs to be part of a comprehensive national development strategy, properly coordinated with other elements of such a policy (chapter 3). FDI alone can never be expected to trigger development and is therefore no panacea for development.

The contribution of TNCs and FDI to inclusive and sustainable development is also a responsibility of TNCs themselves. In particular, TNCs need to abide by internationally accepted standards of responsible business conduct (RBC) rather than simply implementing CSR projects which often amount to charity but are not integrated in the business model and day-to-day operations of the business. Box 2.12 provides a case study of the operations of a TNC lacking responsible business conduct while box 2.13 provides an example of a TNC operating on the basis of responsible business conduct.

Various international bodies have issued standards and principles related to RBC with particular relevance for TNCs. For instance, in 1977 the Governing Body of the International Labour Organization (ILO) adopted the **Tripartite Declaration of Principles concerning Multinational Enterprises and Social Policy** to guide and inspire the conduct of multinational enterprises and how they relate to host governments and employers' and workers' organizations. The principles of the Declaration reflect good policy and practice in such areas as employment, training, conditions of work, safety and health, and industrial relations.[36]

The **OECD Guidelines for Multinational Enterprises** provides another good example of a government-backed initiative that aims to promote responsible business conduct.[37] The Guidelines are most widely known for their system of National Contact Points through which disputes between relevant stakeholders with respect to the implementation of the guidelines can be addressed. The United Nations Global Compact principles[38] and Guiding Principles on Business and Human Rights[39] are other examples of international guidelines on responsible business.

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36 Available from **http://www.ilo.org/global/topics/employment-promotion/multinational-enterprises/lang—en/index.htm**.

37 Available from **http://mneguidelines.oecd.org/text**.

38 Available from **https://www.unglobalcompact.org/what-is-gc/mission/principles**.

39 Available from **http://business-humanrights.org/en/un-guiding-principles.**

It is important to make TNCs and FDI, and business in general, part of the solution to achieve sustainable development, and not merely view them as the problem. ESCAP (2011) argues that TNCs and business in general are the producers of climate-smart goods, services and technologies and hence play an important role in climate change mitigation. With the adoption of the SDGs, the tide seems to be changing. For instance, the UN Global Compact and KPMG are partnering on the SDG Industry Matrix project to showcase brief industry-specific examples and ideas for corporate action related to each SDG. SDG 17 specifically addresses the need for a global partnership which includes business. However, governments have a responsibility to provide an enabling environment for business to adopt, practice and implement standards and principles of responsible business conduct.

In summary, FDI can have a net positive impact on host countries' economies and inclusive and sustainable development, but this impact depends on a host of conditions, including the mix of policies and extent of the rule of law. Chapter 3 will present a more comprehensive policy framework for sustainable FDI.

Box 2.12. Case study of negative impact of TNCs on host country sustainable development: Asia Pulp and Paper in Indonesia

Asia Pulp and Paper (APP) is an Indonesian TNC which has been accused on various occasions of deforestation, conflict with local communities, forest fires for clearing land and encroaching on established tiger territories, mostly in Indonesia. Although the practices of APP in Indonesia do not constitute FDI, it is a large TNC engaging in unsustainable business practices which are a good example of the lack of responsible business conduct prevalent in so many TNCs. Indonesia could be regarded as both the home and host country of APP. APP serves world markets and is owned by Sinar Mas, which had close ties to the Suharto regime. Its main operations outside Indonesia are in Cambodia and China.

APP's environmental record has been dismal by most accounts. According to a Friends of the Earth report from 2005, APP has cleared over 280,000 hectares of rainforest in the past decade, and planned to cut another 300,000 over the next five years. The company has been at the centre of many environmental controversies and has been accused of being involved in illegal logging in Cambodia and in Indonesia. The company is also known for defaulting on debt repayments in 2001, during a period of wide-scale financial problems in the South-East Asian subregion. Aware of its negative image abroad, APP entered into various agreements with the World Wide Fund for Nature (WWF) in 2003 and a partnership with Rainbow Alliance in 2005 on the sustainable management of rainforests but these agreements were all terminated due to alleged violations or circumvention by APP. In November 2007, Forest Stewardship Council (FSC) formally disassociated itself with APP, rescinding the rights of APP to use its logo.

Most recently, and partly as a result of a consistent Greenpeace campaign which led to an exodus of APP clients, APP has renewed efforts to come clean. In June 2013, APP published its Sustainability Roadmap Vision 2020. As part of an update to its "Vision 2020" plan and Forest Conservation Policy, APP announced an absolute deadline of 31 August 2013 for all natural forest wood felled prior to 1 February 2013 to reach its pulp mills. No natural forest fiber would be allowed in APP operations past this date. It also requested renewed dialogue with FSC. APP adopted a zero-deforestation pledge in early 2013 but later admitted itself it had violated the pledge on various occasions. In November 2015, it was accused by more than 100 Singaporean companies of allowing fires in their concession areas and faced a boycott of its products among other companies. Again, APP vowed to rebrand itself and announced successful efforts in forest conservation and peatland restoration. According to APP statements made in early 2016, the company had conserved 600,000 hectares (ha) of natural forests in the past three years and restored 7,000 hectares of peatland since August 2015. The company's efforts have received praise but its credibility lies in long-term actions and commitments to responsible business conduct.

Sources: Available from **http://appwatch.blogspot.com/2007/02/social-conflict-and-environmental.html; http://www.thejakartapost.com/news/2016/02/05/app-rebrands-itself-environmental-champion.html; http://www.thejakartapost.com/news/2010/10/22/how-mncs-threaten-our-environment.html; http://www.worldwildlife.org/press-releases/paper-giant-app-s-greenwashing-campaign-hides-forest-destruction; http://www.theguardian.com/environment/2013/feb/05/paper-firm-indonesian-deforestation; http://www.theguardian.com/environment/2014/mar/26/app-deforestation-greenpeace-campaign.**

5. A framework for measuring impact

Finally, in order to measure the impact of FDI on inclusive and sustainable development, various indicators can be applied. Some of them are contained in table 2.4.

Box 2.13. Case study of positive FDI impact on host country sustainable development: Unilever Viet Nam

Unilever Viet Nam (UVN) started business in 1995 and was among the first TNCs to establish a subsidiary in Viet Nam. UVN has achieved on average double-digit annual growth and has become one of the most successful foreign investors in Viet Nam. According to the Central Institute for Economic Management (CIEM)'s report (2009), UVN has demonstrated its willingness to make a significant contribution to Viet Nam in many respects.

According to the report, the major impacts of UVN in Viet Nam include:

- Employment generation: UVN directly employs more than 1,500 people and has created nearly 10,000 indirect jobs through establishing linkages with suppliers and distributors.
- Contributions to tax revenue and external finance: UVN is among the largest tax contributors to the state budget as a direct result of its strong business performance and has made positive impacts on the balance of trade and balance of payments.
- Linkage with local partners: UVN is a long-term investor and has strong forward and backward linkages. It has formed a diverse network of partnerships with local suppliers and manufacturers, most of them being local SMEs. UVN has helped its partners obtain necessary skills, experience, techniques and working discipline to become more efficient and competitive through assistance and training. The 'trickle-down' effects have been significant and sustainable.
- UVN provides quality products to customers, including rural and low-income people, with an aim to improve their hygiene habits and provide better nutrition.
- UVN has made sustainable impacts on the community through its CSR policy. For example, in the five year period from 2005 to 2011, UVN, through its Unilever Vietnam Foundation, has invested in socio-community programmes under the strategic partnerships with relevant government agencies which focus on four main areas: health and hygiene with the Ministry of Health; education and child development with the Ministry of Education & Training; women empowerment with Viet Nam's Women Union; sustainable tea development with the Ministry of Agriculture & Rural Development.

UVN's significant contribution to Viet Nam provides a positive experience for other TNCs and policy makers. However, it should be noted that UVN's business model relies heavily on local businesses for supply and distribution, resulting in a relatively high impact on local economies (Rhijn, 2010). Also, despite its top-level commitment to sustainability and social responsibility, UVN fell short of fulfilling its corporate responsibilities when it came to labour issues. As Oxfam (2013) claims, UVN's competitive advantage is still pursued through pressure on labour costs, which pushes costs and risks onto workers. In order to enhance positive impacts, UVN is encouraged to address the issue of low wages and precarious work in the supply chain and to adopt a more people-centred approach in consultation with workers.

Source: Unilever Viet Nam; references quoted in text.

Table 2.4. Indicators of sustainable FDI

Economic	Contribution of FDI to GDP growth, net exports, employment, (gross) capital formation, net capital inflows, government revenue, extent of forging linkages with domestic SMEs, technology transfer and absorption, competition, infrastructure development, etc.
Social	Contribution of FDI to skills development, community development, women and disadvantaged groups employment, health benefits and pension plans, minimum wage and level of labour conditions (e.g. conformity with ILO labour standards), extent of CSR programmes and their results, number of families lifted out of poverty, accessibility and affordability of goods and services produced.
Environmental	Level of environmental pollution (air, water, ground), level of GHG emissions, level of energy efficiency and water consumption, level of discharge of waste and recycling, application and transfer of environmentally sound technologies, etc.

C. DISCUSSION ISSUES

1. What has been the trend in FDI in your country/location? Has it increased or decreased? Can you specify why this happened?
2. Which sectors attract the most FDI in your country/location? Why are these sectors attractive? In which sectors would you like to see FDI increase?
3. Which areas/locations in your country attract the most FDI and why?
4. Which countries account for most inward FDI in your country/location?
5. Which forms of FDI are the most prominent in your country/location? Greenfield or M&A?
6. Which type of FDI is the most prominent in your country/location? Market-seeking, resource-seeking, efficiency-seeking or strategic-asset seeking?
7. What impact has FDI had on your country's GDP, (women's) employment, skills development, technology acquisition and utilization, balance of payments, tax revenue? How does this impact compare to domestic investment?
8. How do you rate your country's absorptive capacity in target sectors for benefiting from FDI?
9. What social and environmental impact has FDI had in your country? For instance: Has FDI led to the displacement of people without due compensation? Has FDI led to higher levels of air, water and land pollution, unsustainable deforestation or damage to pristine land or agricultural land? Has FDI had a positive impact on the environment?
10. How do foreign investors' behaviour and track record on responsible business compare to that of domestic investors?
11. What tools do you use to measure impact?
12. What is needed to improve the behaviour of foreign investors or to attract higher quality investors?

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CHAPTER THREE

3

POLICY FRAMEWORKS FOR SUSTAINABLE FOREIGN DIRECT INVESTMENT

A. ECONOMIC, FINANCIAL AND INVESTMENT LIBERALIZATION, PRIVATIZATION AND FOREIGN DIRECT INVESTMENT

1. Liberalization of foreign direct investment

The promise of FDI as an engine for economic development has gained momentum over the last 20 years. In the 1970s, many developing countries were mistrustful of TNCs, fearing a loss of sovereignty and preferring to borrow from banks to finance development projects. That changed with the debt crisis of the 1980s, when FDI was considered a potential source of capital (e.g. Edwards, 1990). FDI assumed an even more important role in the 1990s as developing countries increasingly embraced export-oriented development strategies (e.g. Singh and Jun, 1995; Kohpaiboon, 2003).

Over time, investment policies and strategies have evolved and investment promotion strategies have adapted (box 3.1). To attract FDI, developing countries were told in the 1980s to "get the prices right," that is, to eliminate micro-policies, such as energy and food subsidies, which created a gap between domestic and global prices. In the early 1990s, the prescription proffered by the IMF was to "get the policies right": developing countries should embrace market-oriented macroeconomic liberalization policies, especially the privatization of state-owned enterprises, deregulation of financial markets and reduction of trade barriers, which promote global integration (IMF, 2001). In the late 1990s and early 2000s it was observed that liberalization by itself was not sufficient to attract FDI and countries were requested to establish an "enabling environment" by cutting red tape and engaging in active investment promotion and facilitation, including aftercare through the establishment of specific purpose investment promotion agencies (IPAs). In the second half of the 2000s, voices grew louder in insisting that FDI should be "sustainable" and contribute to sustainable development and not be promoted for its own sake. This section covers the issue of investment liberalization and the wider role of economic liberalization and privatization in attracting FDI.

Box 3.1. A fourth generation of investment promotion strategies?

The evolvement of investment policy has been accompanied by shifts in investment promotion strategies. The economic liberalization drive gave rise to what has been termed "*first generation*" investment promotion strategies. It was a passive stage in terms of seeking investment where investment promotion was equated with investment policy (through liberalization), but it was necessary for ensuring that host countries would be open to receive FDI. IPAs had no role in this stage.

This was followed by the "*second generation*" of investment promotion strategies. At that stage, many IPAs were established to actively promote and facilitate FDI as distinct from investment policy, and investment promotion became pro-active through the marketing of the host country as an investment location. "*Third generation*" investment promotion strategies followed and are current practice of most IPAs. These strategies are aimed towards the targeting of specific industries (or even individual firms) that are deemed to be a good match for the host country. This has further sharpened the different roles of investment policy and investment promotion.

Following this progression, according to UNCTAD the latest development is the emergence of a "*fourth generation*" of investment promotion, in which IPAs focus on attracting sustainable FDI in line with the new generation of investment policies. In its World Investment Report 2014, UNCTAD presents a detailed action plan for promoting private sector investment in the SDGs and development of a new generation of investment promotion strategies and institutions. In practice, however, very few IPAs focus on sustainable development as a clear goal and the incorporation of sustainable development considerations remains a work in progress.

Source: UNCTAD (2001) as quoted in VCC/WAIPA (2010) and UNCTAD (2014).

Investment liberalization has continued to be an important policy tool that corrects economic distortions and improves the efficiency of economic and investment transactions. Implemented sustainably and with commitment, liberalization efforts send messages to investors that a host country is open to business and (foreign) investment. Investment liberalization is motivated by both internal and external factors. Internal factors relate to perceptions that FDI is good for development while external factors relate to pressures from international organizations such as the IMF and World Bank (the so-called "Washington Consensus"). Kobrin (2005) found that internal factors play a more important role than external factors. There was also the perception that the role of FDI became more important as other forms of external assistance dwindled while governments were more confident that they could maximize the benefits of FDI and minimize the costs (UNCTAD, 1994). Kobrin also notes that the motivation for liberalization is related to country size (smaller countries have less recourse to domestic engines of growth), level of development (higher development levels attract more FDI and allows for better absorption of FDI benefits), and trade openness (trade-oriented countries are attractive for FDI).

Investment liberalization generally refers to reducing the following (non-exhaustive) constraints to FDI[40]:

- Restrictions on sectors in which FDI can be made;
- Restrictions on the value of FDI;
- Restrictions on the level of foreign ownership;
- Compulsory joint ventures with local firms;
- Controls on repatriation of profits;
- Performance requirements, e.g. export requirements, local content requirements, technology transfer requirements, skills development requirements; trade balancing requirements;
- Import restrictions.

Free trade agreements, international investment agreements and WTO agreements all have contributed to investment liberalization apart from unilateral liberalization initiatives prompted by both internal and external considerations. Chapter 4 explores the international regulatory regime for FDI in more detail while Chapter 5 addresses the issue of performance requirements.

2. Foreign direct investment in the context of economic, trade and financial liberalization

There is evidence that investment liberalization has become increasingly competitive among countries in their efforts to attract FDI (Cooray and others, 2014). While there are many studies evaluating the impact of economic liberalization or financial liberalization on economic growth and poverty reduction, there are not many that focus on the impact of FDI liberalization alone. ESCAP (2009a) sites various studies that show a positive impact of trade liberalization on economic growth (which, in turn acts as a determinant for FDI),[41] while a few show the opposite. A United Nations DESA report (United Nations, 2009) also finds mixed results of the impact of economic, trade and financial liberalization on economic growth and poverty reduction. Basu and others (2007) find that growth and FDI are not mutually reinforcing under restrictive trade and investment regimes.

40 See, e.g. **http://cuts-international.org/CCIER-3-2003.pdf.**

41 It is less clear what impact trade liberalization has on FDI inflows. Where trade and investment are complementary, trade liberalization would be expected to have a positive impact. However, the linkage between trade and investment are complex and highly sector and investor-specific (see, for instance, Martens, 2008). Hong (2008) found a positive relation between China's accession to the WTO and inflows of FDI. Cuong (2013) found a similar positive relation for Viet Nam. Depending on the depth and scope of free trade agreements, such agreements can be expected to have a similar effect on FDI. Of course, accession to WTO and recent far-reaching FTAs such as the Trans-Pacific Partnership Agreement go beyond trade liberalization and commit WTO-acceding countries or partners to FTAs to improve the overall rule of law and establish a more conducive investment climate.

The actual experience of the Asia-Pacific region has shown that the shift from inward-looking import-substituting economic policy towards outward-looking export-oriented policy, including a more welcoming attitude towards FDI, has led to the so-called "Asian Miracle" of high economic growth. The Asian experience has also shown that such liberalization needs to proceed in a controlled and sustainable manner. Stiglitz (2000) argues that financial and capital market liberalization without the presence of an effective regulatory framework was at the core of the problem of the Asian 1997 financial crisis. The recent 2008 economic crisis has also been blamed on unsustainable financial liberalization and deregulation in the United States (Crotty, 2009).[42] Liberalization is necessary to ensure *efficiency* of markets while regulation is necessary to ensure their *stability*. Also, liberalization and regulation need not apply to the same areas. For instance, while liberalization of FDI is generally considered a good thing, the same cannot be said for liberalization of the much more volatile foreign portfolio investment. This is important for countries signing international investment agreements which cover such portfolio investment under the definition of investment. However, while financial liberalization in itself may become unsustainable, it is an important determinant for FDI (Boukabry and others, 2009).

The challenge, therefore, is to find the proper balance between economic and financial liberalization and deregulation on the one hand and prudential supervision and regulation on the other hand, both in terms of focus and extent of coverage. It can be argued that the liberalization of FDI is essential to attract FDI for obvious reasons. Stringent ownership and sector restrictions and performance requirements are clearly a disincentive for FDI. However, if countries have other attractions for FDI that enable foreign investors to generate a return on investment despite the relatively high level of overall economic repression, those investors may still consider investing in such a country, in particular if the country is large. Smaller countries may have limitations in overall attraction to FDI so have no choice but to liberalize. This is shown by the experiences of Singapore, a small country with a very liberal investment regime and high dependence on FDI for economic growth and China, a large country with a moderately liberal investment regime but still relatively high level of economic repression and state influence on the economy, but with high levels of FDI inflows. Then there is India, a large economy with continuing economic repression (and lacking a conducive investment climate) and a relatively low (though rising) levels of FDI inflows. On the basis of country experiences, it is safe to conclude that investment liberalization alone is not sufficient for development and that investment liberalization by itself, while essential, is not sufficient to attract investment (UNCTAD, 1994).

3. Foreign direct investment and privatization

One important aspect of economic liberalization is privatization. Privatization assumed great importance in the countries with economies in transition in the 1990s and early 2000s and is still an important modality to reduce state interference in the economy or to address budget deficits. In particular, privatization through FDI has played an important role in China and India and countries in Central Asia (Mukherjee and Suetrong, 2009). Boubakri and others (2009) identify various channels for the interrelationship of privatization and FDI: (a) privatization improves the investment climate (less government, more private sector); (b) privatization leads to economic growth (private sector is more efficient than the government); (c) privatization, through share issue, develops the financial sector which is in many cases an important determinant for FDI. Their findings suggest that privatization can be instrumental in attracting FDI, in particular when privatization proceeds through share issue, while FDI is important for privatization. Mukherjee and Suetrong (2009) also find a strong two-way causality between privatization and greenfield FDI. FDI is considered an attractive modality to dispose of state assets in particular in cases where the domestic enterprise sector would not have the ability or willingness to buy these assets. It is particularly attractive to strategic-asset seeking FDI but also to other types of FDI seeking an easy entry into a market through M&As. Furthermore, apart from capital, FDI could bring technology and management expertise. FDI has also become an important modality for public-private partnerships, especially in large-scale infrastructure projects such as ports, roads, airports, subway etc., for instance through build-own-operate (BOO) and build-operate-transfer (BOT) arrangements, but its success depends on the quality of the domestic regulatory framework (Kirkpatrick and others, 2006).

[42] See also: **http://socialdemocracy21stcentury.blogspot.com/2009/11/financial-deregulation-and-origin-of.html**, and: **http://krugman.blogs.nytimes.com/2011/11/08/boom-for-whom.** Howeve, this observation is not universally shared. Some have demonstrated that the number of financial restrictions has actually increased between 1999 and 2008. See for instance: **http://mercatus.org/publication/did-deregulation-cause-financial-crisis-examining-common-justification-dodd-frank, http://www.cato.org/policy-report/julyaugust-2009/did-deregulation-cause-financial-crisis**, and: **http://www.aei.org/publication/deregulation-and-the-financial-crisis**. As usual, the truth may lie somewhere in the middle.

However, in many cases state-owned enterprises (SOEs) in developing countries are dominant in sensitive sectors such as banking, utilities, energy, transport, water and sanitation, and telecommunications which are quite often not open to FDI. Where such SOEs operate under monopoly power, the transfer of such power to a foreign-owned enterprise may be seen as a loss of sovereignty (e.g. Wang, 2003). In particular, private sector monopolies may exploit their economic power, leading to supernormal profits (high “producer surplus”) and reduced consumer welfare (a lower “consumer surplus”). Consumers may suffer from no – or a limited choice of – goods and services and face higher prices due to the lack of competition (Kirkpatrick and others, 2006). The take-over of SOEs by foreigners also frequently results in job losses as the enterprise is made more efficient and competitive. Therefore, privatization in general, and involving FDI in particular, is often not popular among the general population so it is important to have safety-nets and retraining programmes in place. Privatization is most successful if it proceeds on the basis of a transparent (bidding) process, within a solid and clear legal and regulatory framework and the privatized enterprise operates in a competitive environment. Box 3.2 shows the problems encountered in Kazakhstan in the early reform process including privatization. Table 3.1 shows the most critical success factors for privatization. As a detailed analysis of these success factors falls outside the scope of the present handbook, reference is made to the source of table 3.1 for a more comprehensive explanation. See also Tetteh (2013).

Box 3.2. Early privatization problems in Kazakhstan involving FDI

Kazakhstan underwent a comprehensive reform process in the 1990s and encountered a number of problems related to the revitalization of industries through privatization, including through privatization. Most of Kazakhstan’s large industrial enterprises were privatized in 1996, with foreign interests being the buyers or joint venture partners in most cases. Among the complexes sold were key facilities such as the Qaragandy metal plant, which produces ferrous metal items, and which was one of the biggest of such plants in the former Soviet Union. There was also the Sokolov-Sarbay iron ore developing factory; the Yuzhneftegaz oil company’s Kumkol field; the heating and power system of Almaty city and others.

In all, 70% of all enterprises were sold into private hands, raising about $263 million for the state treasury. The involvement of foreigners in the process to such a great degree was not popular with a public raised in an atmosphere of hostility to foreign capitalists. And workers who had been told that sale to foreign owners would solve the chronic problem of unpaid salaries soon learned that the outsiders had not brought any magic formulas with them.

The situation was made more acute by the fact that in Kazakhstan many of the smaller towns were established in the Soviet era specifically to serve as housing areas around a major plant. Therefore, any economic problems with the local plant produced a catastrophic impact on the town. The realization among workers that the sale of public assets to foreign ownership would not immediately improve their situation was a contributing factor in the mass protest actions and hunger strikes which broke out in central Kazakhstan in 1996.

One foreign takeover shows some of the pitfalls. In 1996, the head of Global Mineral Reserves Incorporated, a joint venture including Western partners, signed an agreement with the local Committee on State Possessions taking over the Shubarkol Coal Mine in the central Qaragandy region. The agreement contained clauses that Global would take a number of steps to improve the living conditions of the mine workers. However, it turned out that Global was not able to meet those obligations because of a lack of finance.

Other privatization efforts ran into political problems. For instance, Parliament heard complaints from the mayor of Almaty about Samsung Corporation, which had bought the Jezkazgan Non-Ferrous Metals plant in Central Kazakhstan. The mayor alleged that Samsung had not been using its own money for the development of the purchased plant, but had been using finance provided by the Kazakh Government. The mayor also criticized the owners of the Qaragandy Metal Plant, a joint venture called Ispat-Karmet on the same grounds, saying they had not brought in real investment from abroad. His statements heightened rumours about corruption among government members.

One foreign company which had a particularly lively time in 1996 was the Belgian firm Tractebel, which took over the Almaty electrical and heating supply system. As part of an efficiency drive they cut staff. That led to worker demonstrations. They announced increased fees. That led to consumer resistance. They cut off supplies for a few days to some suburbs of the capital as a reminder to local authorities to take the payment of bills seriously. That led to further uproar. Tractebel’s aim was to put the supply company on a rational economic basis, thus in the long run ensuring efficient service to its customers. But its efforts were widely misunderstood. Tractebel was however persisting, and has issued assurances that 1997 would be a better, smoother year. It later reached an agreement with trade unions on paying wage arrears. The Government of Kazakhstan also issued assurances that the privatization process would start to bear fruit in coming years in the form of re-invigorated companies.

Source: Merhat Sharipzhan, “Kazakhstan: A case study of privatization problems.” Radio Free Europe/Radio Liberty. 9 January 1997. Available from: **http://www.rferl.org/content/article/1083013.html..**

Table 3.1. Critical success factors for privatization

1.	Stable macroeconomic condition;
2.	Favourable legal framework;
3.	Sound economic policy;
4.	Available financial market;
5.	Multi-benefit objectives;
6.	Appropriate risk allocation and risk sharing;
7.	Commitment and responsibility of public and private sectors;
8.	Strong and good private consortium;
9.	Good governance;
10.	Project technical feasibility;
11.	Shared authority between public and private sectors;
12.	Political support;
13.	Social support;
14.	Well-organized and committed public agency in charge of privatization;
15.	Competitive procurement process;
16.	Transparent procurement process;
17.	Government guarantees;
18.	Thorough and realistic assessment of costs and benefits.

Source: Ismail and Ajija (2013).

B. THE NEED FOR AN ENABLING CLIMATE AND PRO-ACTIVE INVESTMENT PROMOTION

1. What constitutes a good investment climate?

As competition for FDI among both developing and developed countries is intense, the focus of investment policy has shifted towards fashioning the right "enabling environment" for FDI: the legal, regulatory and political institutions which provide transparency, protection and stability to foreign (and domestic) investors; and social infrastructure, such as education, which increases the skills of the local workforce to meet the requirements of TNCs (OECD, 2002; Rajan, 2004). Developing countries which have such an "enabling environment" are, indeed, quite successful in attracting FDI, though often with high attendant social and environmental costs. Most developing countries, however, especially the LDCs, lack a conducive investment environment. The existence of pro-active IPAs and one-stop approval processes may compensate partly but never fully for the lack of a conducive investment environment. While such an environment is necessary to attract FDI, FDI itself can help foster sustainable development and nurture local conditions and capacities – productive, social, regulatory and institutional.

The World Bank (2004), in its World Development Report 2005, notes that a good investment climate, both for domestic and foreign investors, is central to growth and poverty reduction. It defines **investment climate** as: "the location-specific factors that shape the opportunities and incentives for firms to invest productively, create jobs, and expand." Box 3.3 summarizes some of the findings of the Report in short observations.

Investment policy therefore needs to improve the investment climate by addressing the barriers faced by investors and to reduce their risk. Some of the most salient barriers are (World Bank, 2004):

- **High risks** associated with policy uncertainty (official policies are not implemented and/or changed too often) and arbitrary and stringent regulation (including unclear or non-transparent property rights, labour laws, or arbitrary implementation of laws and regulations), macroeconomic instability (e.g. high debts and inflation or deflation/stagflation) and overall lack of security from crime and potential natural disasters.
- **High costs** of doing business including taxes, utility costs, import tariffs and non-tariff barriers, borrowing and accessing finance, costs of complying with corruption, high cost of labour, etc.

Box 3.3. Key World Development Report 2005 observations

"A good investment climate is not just about generating profits for firms – if that were the goal, the focus could be limited to minimizing costs and risks. A good investment climate improves outcomes for society as a whole. That means that some costs and risks are properly borne by firms."

"A good investment climate provides opportunities and incentives for firms – from microenterprises to multinationals—to invest productively, create jobs, and expand."

"A good investment climate encourages firms to invest by removing unjustified costs, risks, and barriers to competition."

"As a result of investment climate improvements in the 1980s and 1990s, private investment as a share of GDP nearly doubled in China and India."

"A good investment climate encourages higher productivity by providing opportunities and incentives for firms to develop, adapt, and adopt better ways of doing things – not just innovations of the kind that might merit a patent but also better ways to organize a production process, distribute goods, and respond to consumers."

"Improving policy predictability can increase the likelihood of new investment by more than 30 per cent."

"Improving government policies and behaviours that shape the investment climate drives growth and reduces poverty."

"Experience shows that progress can be made by addressing important constraints in a way that gives firms confidence to invest, and by sustaining a process of ongoing improvement."

Source: World Bank (2004).

- **Low skills** level of labour force and low capacity of domestic enterprises as the determinants of FDI are moving from low skills to semi- and high-skills and international product standards are rising.
- **Inadequate availability of infrastructure** such as access to land, adequate transport and telecommunications services.

The policy implications are evident, i.e. reduce risks and costs, and improve skills and infrastructure. The second two sets of barriers are related to improving factor conditions as part of strengthening national competitive advantages (see section C below) and require a longer time frame. The first two sets of barriers can be addressed through short-term measures that can offer immediate relief to investors. However, the implementation of measures to address these constraints has to balance the requirements of society as a whole to ensure that FDI contributes to sustainable development. For instance, while investors favour policy stability, developing countries cannot be expected to keep their laws and regulations unchanged forever as they develop and require additional and revised laws and regulations. While investors obviously prefer low or no taxes, taxation is essential for the government to provide the necessary facilities for investors (e.g. skills, infrastructure). Investors also prefer less or no competition, but for the sake of economic efficiency, competition is essential and governments have to ensure that barriers to market entry and exit are low and that a healthy level of competition and a level playing field is maintained. Competition is another important determinant of national competitive advantage (see section C below). And while investors prefer as few regulations as possible, regulations are necessary to ensure the stability of markets and benefits for society from FDI (World Bank, 2004). Therefore, a good investment policy addresses these issues and strives to achieve the right balance of interests of all stakeholders. In addition, investment policy requires proper coordination with other related policies.

Barriers faced by investors can be distinguished into those faced in the *pre-establishment phase* and *post-establishment phase*. In the pre-establishment phase, investors have problems evaluating sites and/or obtaining an investment license and other required permits (work permits, residence permits for spouses etc.). In the post-establishment phase investors encounter problems related to setting up production facilities (the actual investment) – including problems related to site clearance and obtaining local permits and licenses and ensuring proper cooperation from local authorities – and starting actual operations (erratic labour regulations, customs clearance issues, high frequency of labour and safety inspections etc.). Investment policy has to address pre-establishment problems through liberalization and deregulation while addressing obstacles in the post-establishment phase requires the services of a qualified IPA in the form of investment facilitation and aftercare (see chapter 8).

Improving the investment climate needs to proceed on an incremental basis to ensure its sustainability. Various countries in the region have consistently strived towards improving the investment climate but it remains a work in progress in most (boxes 3.4 and 3.5).

Box 3.4. Improving investment climate: the experiences of China and India

China and India have grown at high rates until recently and FDI has played an important role in both, though more in China than in India. One reason is that China has made more efforts in improving the investment climate. However, even today neither country has an ideal investment climate. China only recently gave constitutional recognition to private property, and its banking sector is dragged down by nonperforming loans while the stock market seems to be prone to volatility. Undue government intervention and the dominance of SOEs in access to government support remain issues for both domestic and foreign private sector investors. Problems in India's power sector and continuation of state control are legendary along with continuing ownership restrictions and access to land. In India, both the federal and state governments wield considerable power to make the life of investors difficult, the first mostly in the pre-establishment phase and the latter mostly in the post-establishment phase.

Both countries unleashed growth and reduced poverty through what appeared to be fairly modest initial reforms. China began with a rudimentary system of property rights that created new incentives for a substantial part of its economy. India began with early efforts to reduce trade barriers and other distortions that covered a significant part of its economy. In both cases the reforms addressed important constraints, and were implemented in ways that gave firms confidence to invest. And the initial reforms have been followed by ongoing improvements that addressed constraints that were less binding initially, and also reinforced confidence in the future path of government policy. Both countries have steadily made progress in the World Bank's East of Doing Business rankings, although India remains far behind China (table 3.3).

At the moment, there are many outstanding issues in both countries. In India, major areas of concern include corruption, taxes, caps on foreign equity ownership, inadequate financing at reasonable rates, complex and lengthy investment approval and land acquisition processes, antiquated labour laws, and poor contract sanctity and enforcement of arbitration judgments. India imposes restrictions on foreign equity ownership in many sectors, and in particular in the service industries. Sectors such as railway freight transportation and forestry are dominated by public monopolies and are closed to foreign equity participation. With the exception of certain activities specified by law, foreign ownership in the agriculture sector is also not allowed. Though the current Government is reform-oriented it faces a lot of opposition from entrenched interests while corruption remains a major concern. There is also a divide between federal level and state level which makes nation-wide implementation of reforms difficult. For instance, when the Government liberalized FDI in multi-brand retail in 2013, the liberalization measures not only came with many restrictions attached but also left it to individual states whether or not to implement them. There are differences at the state-level in political leadership, quality of governance, regulations, taxation, labour relations, and education levels.

China liberalized its investment regime substantially as part of its WTO membership requirements but maintains strict state control over large parts of the economy. Stock market crashes in 2015 were widely interpreted as market concerns with unsustainable state controls which interfere with the efficient forces of a market economy. On the 13th March 2015, the National Development and Reform Commission ("NDRC") and Ministry of Commerce ("MOFCOM") jointly released the 2015 version of the Catalogue for the Guidance of Foreign Investment Industries ("2015 Catalogue") to replace the current catalogue adopted in 2011 ("2011 Catalogue").[43] The 2015 Catalogue entered into effect as from 10 April 2015. It lists 349 "encouraged", 38 "restricted" and 36 "prohibited" industries. It contains a number of relaxations of restrictions that mainly focus on sectors such as steel, ethylene, refinery, paper, coal chemical equipment, automobile, electronics, liquor, branch railway, subway, international maritime transport and e-commerce. Compared with the 2011 Catalogue, the business sectors that require foreign investors to partner with a Chinese investor has been reduced from 43 down to 15, while the industrial sectors requiring majority Chinese ownership were reduced from 44 down to 35. Restrictions in the culture and entertainment industries remain. China is also in the process of adopting a new Foreign Investment Law, the draft of which was released in 2015. The Draft FIL will liberalize the system so that overseas investors are not required to go through the Central Governmental approval process. In turn, a new "Negative List" regime has been introduced. Investors will only need to seek governmental approval for investing in sectors which are classified as "restricted" on the "Negative List". Most of these are related to security concerns. In other words, foreign investors will have to gain security clearance from the government for investments that are considered harmful to national security, in particular in sectors such as defence, energy, grains, information technology.

Sources: World Bank (2004); World Bank: **http://rru.worldbank.org/BESnapshots/India/default.aspx.**; United States Department of State: **http://www.state.gov/e/eb/rls/othr/ics/2014/228298.htm**; **http://www.fticonsulting.com/~/media/Files/us-files/insights/white-papers/indias-investment-climate-under-the-new-government.pdf.**; **http://www.chinadaily.com.cn/bizchina/2015-01/19/content_19351576.htm**; **http://www.nortonrosefulbright.com/knowledge/publications/125226/china-new-law-shakes-up-foreign-investment-regime**

[43] Available from **http://www.fdi.gov.cn/1800000121_39_4830_0_7.html.**

Box 3.5. A conducive investment climate: Singapore

Singapore has put a lot of emphasis on the role of FDI in its development and has evolved as an investment hub in ASEAN. Though the Government is heavily involved in directing economic development, it has largely relied on market forces and adopted a very liberal investment regime. Exceptions to Singapore's general openness to foreign investment exist in telecommunications, broadcasting, the domestic news media, financial services, legal, and other professional services, and property ownership. The World Bank's Doing Business 2015 report ranked Singapore as the easiest country in which to do business (table 3.3). The Economic Development Board (EDB), Singapore's investment promotion agency, focuses on securing major investments in high value-added manufacturing and service activities as part of a strategy to replace labour-intensive, low value-added activities that have migrated offshore.

Foreign and local entities may readily establish, operate, and dispose of their own enterprises in Singapore. Foreign investors are not required to enter into joint ventures or cede management control to local interests, and local and foreign investors are subject to the same basic laws. Apart from regulatory requirements in some sectors, Singapore places no restrictions on reinvestment or repatriation of earnings or capital. There are no restrictions on foreign ownership of industrial and commercial real estate. The judicial system upholds the sanctity of contracts, and decisions are effectively enforced. The ownership of residential properties including land by foreigners is restricted to those who make adequate economic contributions to Singapore. The ownership restrictions are provided in the Residential Property Act. Telecommunications and transport are sectors open to FDI and measures are taken to prevent monopolistic behaviour. Some restrictions remain in the media sector. For instance, the Newspaper and Printing Presses Act restricts equity ownership (local or foreign) to 5% per shareholder and requires that directors be Singapore citizens. The Government eased restrictions on foreign banks in 1999 with subsequent phased-in further liberalization measures such as the removal of a 40% ceiling on foreign ownership of local banks and a 20% aggregate foreign shareholding limit on finance companies.

Singapore strives to promote an efficient, business-friendly regulatory environment. Tax, labour, banking and finance, industrial health and safety, arbitration, wage and training rules and regulations are formulated and reviewed with the interests of both foreign investors and local enterprises in mind. The Government has established a centralized Internet portal — www.reach.gov.sg — to solicit feedback on selected draft legislation and regulations. Singapore's prescribed accounting standards (Financial Reporting Standards or FRS) are aligned with those of the International Accounting Standards Board. Singapore has developed one of the stronger intellectual property rights (IPR) regimes in Asia, and has taken steps to bring its IPR laws in line with international standards. Singapore typically ranks as the least corrupt country in Asia and one of the least corrupt in the world.

Source: United States Department, Singapore Investment Climate Statement 2015: of State: **http://www.state.gov/documents/organization/241949.pdf.**

A good indication of a country's business and investment climate is provided by the World Bank's indicators on ease of doing business.[44] Table 3.2 lists the indicators and areas of business regulation, which have evolved over time. Table 3.3 shows the ease of doing business rankings of Asian and Pacific economies for selected years. Singapore has consistently shown a global no. 1 ranking but was surpassed by New Zealand in 2017. Various countries in the Asia-Pacific region have demonstrated great improvements in their rankings while the ranking for others has actually deteriorated. While the rankings are indicative, they have to be viewed with care. Jayasuriya (2011), for instance, while showing an increase in FDI inflows with improvements in the ease of doing rankings for the average country, also shows that improvements in the rankings for developing countries translated into only very small (though positive) changes in FDI inflows.

There is no such thing as a perfect investment climate. What constitutes a good investment climate depends on the characteristics and level of development of a given host location (country, province, city, etc.) and whether the investment climate is viewed from the investor's point of view or host country society's point of view. Investors ideally want low or zero taxes, maximum labour flexibility and low wages, freedom to import and export without duties or taxes but protection from competition, free repatriation of profits, no work permits for overseas workers and their families, no restrictions to ownership of property of land, strong intellectual property rights protection, rule of law, reliable dispute settlement systems, i.e. reliable and corruption-free local court system etc. etc. Investors do not like regulation of their businesses but appreciate regulation that ensures security and stability of markets and property rights among others. They also appreciate a pro-active IPA that not only

44 The "ease of doing business" rankings are based on surveys of companies in each country. However, they are not necessarily indicative of a typical foreign investor and especially not a major foreign investor but they nonetheless provide a good overview of the overall business climate in a particular country.

Table 3.2. What “Doing Business” measures – 11 areas of business regulation

Complexity and cost of regulatory processes	
Starting a business.	Procedures, time, cost and paid-in minimum capital to start a limited liability company.
Dealing with construction permits.	Procedures, time and cost to complete all formalities to build a warehouse and the quality control and safety mechanisms in the construction permitting system.
Getting electricity.	Procedures, time and cost to get connected to the electricity grid, the reliability of the electricity supply and the transparency of tariffs.
Registering property.	Procedures, time and cost to transfer a property and the quality of the land administration system.
Paying taxes.	Payments, time and total tax rate for a firm to comply with all the tax regulations as well as post-filing processes.
Trading across borders.	i.e. documents, time and cost to export and import through seaports (2015); Time and cost to export the product of comparative advantage and import auto parts (2017).
Strength of legal institutions	
Getting credit.	Movable collateral laws and credit information systems.
Protecting minority investors.	Minority shareholders’ rights in related-party transactions and in corporate governance.
Enforcing contracts.	Procedures, time and cost to resolve a commercial dispute and the quality of judicial processes.
Resolving insolvency.	Time, cost, outcome and recovery rate for a commercial insolvency and the strength of the insolvency legal framework.
Labour market regulation.	Flexibility in employment regulation, benefits for workers and labour dispute resolution (2015); and aspects of job quality (2017).

Source: World Bank. *Doing Business Report 2015*, table 2 and World Bank. *Doing Business Report 2017*, table 2.1.

Table 3.3. East of doing business rankings, Asian and Pacific economies, selected years
(by 2017 ranking in descending order)

Economy	2017	2016	2015	2012	2010	2006
New Zealand	1	2	2	3	3	1
Singapore	2	1	1	1	1	2
Hong Kong, China	4	5	3	2	2	6
Korea, Rep. of	5	4	5	8	15	23
Australia	15	15	13	10	11	6
Malaysia	23	18	18	18	23	25
Japan	34	34	29	20	19	12
Kazakhstan	35	41	77	47	74	82
Armenia	38	35	45	55	44	37
Russian Federation	40	51	62	120	116	97
Thailand	46	49	26	17	16	19
Mongolia	64	56	72	86	63	41
Azerbaijan	65	63	80	66	55	100
Turkey	69	55	55	71	60	84
Bhutan	73	71	125	142	140	143
Kyrgyzstan	75	67	102	70	47	104
China	78	84	90	91	78	108

Table 3.3. *(continued)*

Economy	2017	2016	2015	2012	2010	2006
Viet Nam	82	90	78	98	88	98
Vanuatu	83	94	76	76	59	54
Brunei Darussalam	84	84	101	83	117	..
Tonga	85	78	69	58	66	46
Uzbekistan	87	87	141	166	150	151
Samoa	89	96	67	60	67	36
Indonesia	91	109	114	129	115	131
Fiji	97	88	81	77	61	29
Philippines	99	103	95	136	146	121
Nepal	107	99	108	107	112	90
Solomon Islands	104	112	87	74	106	61
Sri Lanka	110	107	99	89	102	89
Papua New Guinea	119	145	133	101	108	53
Iran, Islamic Rep. of	120	118	130	144	131	113
Tajikistan	128	132	166	147	149	130
India	130	130	142	132	135	138
Cambodia	131	127	135	138	145	142
Maldives	135	128	116	79	96	49
Palau	136	136	113	116	120	57
Lao PDR	139	134	148	165	169	164
Pakistan	144	138	128	105	75	66
Marshall Islands	143	140	139	106	123	86
Micronesia, Federated States of.	151	148	145	140	139	105
Kiribati	152	149	134	115	91	58
Myanmar	170	167	177	..	..	..
Timor-Leste	175	173	172	168	174	174
Bangladesh	176	174	173	122	111	81
Afghanistan	183	177	183	160	165	159

Source: World Bank, *Doing Business Reports 2006-2017.*
Note: 1. "..": data unavailable; 2. It should be observed that year-to-year changes in the number of economies covered, number of indicators and methodology affect the comparability of prior years; 3. For the year 2017, the number of countries covered in the survey is 190. This number is 189 for 2015 and 2016 and 2017; 183 in 2012 and 2010, and 175 in 2006. Number 1 is the highest ranking.

promotes investment but also provide comprehensive aftercare services. From the government's point of view, an investment climate is optimal when it is sufficiently attractive for foreign investors at increasingly more sophisticated levels on the one hand and when it renders concrete benefits to society in terms of economic and social development with minimum negative environmental externalities on the other hand. After all, FDI is not attracted for its own sake. It has to contribute to sustainable development. Good governance, the proper formulation of laws and regulations and their proper implementation and due enforcement are key to achieving this delicate balance. The legal framework for FDI is further discussed in chapter 4.

Even countries with relatively good investment climates and an overall positive attitude towards investment find that competition for FDI is fierce. Therefore, many have established IPAs for the purpose of active investment promotion, image building and investment facilitation. Modalities for successful investment promotion and facilitation are further discussed at length in subsequent chapters.

Technical assistance on private sector development and improvements in the investment climate are provided by various multilateral agencies, including OECD through its investment policy reviews, UNCTAD, and the World Bank Group. FDI policies are also covered in the regular WRO Trade Policy Reviews. Box 3.6 describes the services provided by the World Bank/Facility for Investment Climate Advisory Services (FIAS), previously known as Foreign Investment Advisory Services and OECD.

Box 3.6. Assessing and improving investment climates: World Bank/FIAS and OECD

The Facility for Investment Climate Advisory Services (FIAS) of the World Bank is an integrated part of the Bank's Trade & Competitiveness Global Practice (T&C) which is a joint service provided with the International Finance Corporation (IFC). Another World Bank agency involved in FDI is the Multilateral Investment Guarantee Agency (MIGA). FIAS has been in existence for 30 years and was previously known as the Bank's Foreign Investment Advisory Services. FIAS currently also covers domestic investment and has provided technical assistance and advice to its client countries worldwide in areas such as private sector development, investment policy and promotion (IPP) and improvement of investment climate. According to its 2015 Annual Review, FIAS has helped bring about 265 reforms in 75 client countries, exceeding the five-year target of 250 reforms for the 2012-2016 period. The IPP product currently delivers solutions in six core areas: (a) investment reform map (IRM); (b) investment promotion; (c) investment incentives; (d) investment entry and establishment; (e) investor protection and retention; and (f) investment linkages and domestic value addition. These programmes are explained in more detail in the 2015 FIAS Annual Review (World Bank, 2016) and available at: https://www.wbginvestmentclimate.org.

Outside FIAS, the World Bank undertakes periodic investment climate assessments at the national level. Most recent reports issued in 2014 assessed the investment climate in Cambodia, Lao People's Democratic Republic and Myanmar (accessible at: **http://documents.worldbank.org/curated/en/docsearch/document-type/904594**).

The OECD Investment Policy Reviews are conducted using the OECD investment instrument and – since its adoption in 2006 – the Policy Framework for Investment (see below and box 3.10). Using a process of peer examination, the OECD Investment Committee has published investment policy reviews since 1993. Priority countries for review are those showing potential for adherence to the OECD investment instruments. Recent investment policy reviews in the Asia-Pacific were conducted for Cambodia (2016), India (2009), Indonesia (2010), Kazakhstan (2012), Lao People's Democretic Republic (2016), Malaysia (2013), Myanmar (2014), Philippines (2015), Russian Federation (2008), and Viet Nam (2016).*

Source: World Bank (2016) and OECD. Available from **http://www.oecd.org/investment/countryreviews.htm**.
* The following country reports were forthcoming at the time of this publication: Cambodia, Lao People's Democretic Republic, Philippines, and Viet Nam.

2. Policy focus: trade facilitation

Trade facilitation measures aim to reduce trade costs. While trade facilitation can take several forms, it mostly refers to reducing red tape at the border, i.e. the simplification, harmonization and reduction of customs and international trade procedures in a narrow sense. In a wider sense, trade facilitation refers to reducing the time and costs it takes to trade across borders. This is also one of the components of the World Bank's ease of doing business indicators. The World Bank's Doing Business Database proxies trade procedures by the time in days required to import (and export). Anderson and van Wincoop (2004) define trade costs as "all costs incurred in getting a good to a final user, other than the cost of producing the good itself:

- transportation cost (both freight costs and time costs);
- policy barriers (tariffs and non-tariff barriers);
- information costs;
- contract enforcement costs;
- costs associated with the use of different currencies;
- legal and regulatory costs and local distribution costs (wholesale and retail)."

ESCAP research based on the ESCAP-World Bank Trade Cost Database[45] has shown that trade costs are decreasing but are still high in the Asia-Pacific region (ESCAP, 2015). Trade costs (calculated as a tariff equivalent) vary widely among subregions with the highest reported in the Pacific and the lowest among China, Japan and the Republic of Korea. ESCAP (2015) finds that trade facilitation plays an important role in reducing trade costs.

Trade costs matter to foreign investors, in particular as there are strong complementarities between trade and investment (see chapter 2). Virtually all types of FDI have some form of trade link. Efficiency-seeking global value chain related FDI in particular relies heavily on international trade and, hence, on open borders and low trade costs. While tariffs on manufacturing goods are generally speaking very low in most countries, non-tariff barriers such as cumbersome trade procedures, continue to pose significant barriers to international trade. Hence, the level of trade facilitation in any given host country would therefore be a strong determinant of trade-related FDI.

Research has produced ample evidence that simplification and harmonization of international trade procedures has the potential to increase both trade volumes and the number of products traded (for an overview, see Persson 2012). Increasingly, research has also found evidence that countries with relatively inefficient or cumbersome trade procedures generally receive less FDI. For instance, an ESCAP working paper found that, though a host country's quality of business regulatory environment generally matters the most, high trade costs also have a significant impact on FDI. In particular, the study finds that a 1% reduction in comprehensive international trade costs (excluding tariff) between source and host country leads to a 0.8% increase in FDI inflows on average. Import tariffs of the host country are also found to have a significant but small negative on FDI inflows. With specific reference to the Asia-Pacific region, it was found that if countries with relatively high tariffs took steps to reduce their average tariff to the developing country average, the region as a whole would see a 6-7% increase in FDI inflows, while reducing other types of trade costs in high-cost countries in Asia-Pacific to the developing country average could be expected to increase FDI flows by 20%. In turn, a moderate improvement in the quality of the domestic business environment in host countries, by just 10% on average across the region, would increase FDI flows by over 60% (Duval and Utoktham, 2014).

An OECD study found that improved and simplified customs procedures would have a significant positive impact on trade flows and government revenue as a result of the more efficient collection of trade taxes. In addition, the study also showed that facilitated cross-border movement of goods would have a positive effect on the ability of a country to attract FDI and to better integrate in international production supply chains (Engman, 2005).

OECD has developed a set of trade facilitation indicators to help governments improve their border procedures, reduce trade costs, boost trade flows and reap greater benefits from international trade. The indicators identify areas for action and enable the potential impact of reforms to be assessed. Table 3.4 gives an overview of the indicators. The full set and country comparisons can be accessed at **http://www.oecd.org/trade/facilitation/indicators.htm.**

Globally, the United Nations Economic Commission for Europe (UNECE) is the international focal point for trade facilitation standards and recommendations. UNECE has developed instruments to reduce, harmonize and automate procedures and paperwork in international trade. This work is supported by the UN Centre for Trade Facilitation and Electronic Business (UN/CEFACT) (box 3.7). UN/CEFACT additionally develops and maintains the only international standard for electronic data interchange (UN/EDIFACT – United Nations Electronic Data Interchange for Administration, Commerce and Transport). This standard is used to exchange structured information between computers and is critical to the implementation of management techniques such as just-in-time manufacturing.[46]

[45] The ESCAP-World Bank Trade Cost Database is the first database of its kind to systematically measure bilateral trade costs. The international trade costs captured by the database are the broad aggregate form, including direct trade costs, indirect trade costs associated with regulatory import and export requirements as well as costs resulting from currencies, language, culture, geography and distance. The recently updated database, which now covers almost 180 countries and economies, provides trade costs data for the manufacturing and agricultural sectors. Domestic and international shipping and logistics costs associated with imports and exports are also included. The database can be accessed at **http://databank.worldbank.org/data/reports.aspx?source=escap-world-bank-international-trade-costs.**

[46] Available from **http://www.unece.org/leginstr/trade.html.**

Table 3.4. OECD trade facilitation indicators: an overview

Advance rulings	Prior statements by the administration to requesting traders concerning the classification, origin, valuation method, etc., applied to specific goods at the time of importation; the rules and process applied to such statements.
Appeal procedures	The possibility and modalities to appeal administrative decisions by border agencies.
Cooperation – external	Cooperation with neighbouring and third countries.
Cooperation – internal	Cooperation between various border agencies of the country; control delegation to customs authorities.
Fees and charges	Disciplines on the fees and charges imposed on imports and exports.
Formalities – automation	Electronic exchange of data; automated border procedures; use of risk management.
Formalities – documents	Simplification of trade documents; harmonization in accordance with international standards; acceptance of copies.
Formalities – procedures	Streamlining of border controls; single submission points for all required documentation (single windows); post-clearance audits; authorized economic operators.
Governance and impartiality	Customs structures and functions; accountability; ethics policy.
Information availability	Publication of trade information, including on internet; enquiry points.
Involvement of the trade community	Consultations with traders.

Source: OECD. Available from **http://www.oecd.org/trade/facilitation/indicators.htm**.

Box 3.7. International recommendations for trade facilitation: UN/CEFACT

Within the United Nations framework of the Economic and Social Council, the United Nations Economic Commission for Europe (UNECE) serves as the focal point for trade facilitation recommendations and electronic business standards, covering both commercial and government business processes that can foster growth in international trade and related services. In this context, the United Nations Centre for Trade Facilitation and Electronic Business (UN/CEFACT) was established as a subsidiary intergovernmental body of the UNECE Committee on Trade, mandated to develop a programme of work of global relevance to achieve improved worldwide coordination and cooperation in these areas. The recommendations of UN/CEFACT have been recognized as internationally accepted recommendations in the area of trade facilitation.

The 35 areas of recommendations are the following: United Nations layout key for trade documents; locations of codes in trade documents; ISO country codes for representation of names of countries; national trade facilitation bodies; abbreviations of International Chamber of Commerce's trade terms, known as INCOTERMS; Aligned Invoice Layout Key for international trade; establishment of a method for a standardized and unambiguous all-numerical designation of a given date, time of day and period of time; unique identification code methodology which is a unique referencing system for use between parties as a means of referring to a trade transaction and/or consignment; alphabetic code for the representation of currencies; codes for the identification of ships; documentary aspects of the international transport of dangerous goods; measures to facilitate maritime transport documents procedures; facilitation of identified legal problems in import clearance procedures; authentication of trade documents; simpler shipping marks; implementation of UN/LOCODE – Code for Trade and Transport Locations; abbreviations for certain terms of payment, referred to as "PAYTERMS", for use in international trade transactions as appropriate; facilitation measures related to international trade procedures; codes for modes of transport; codes for units of measure used in international trade; codes for passengers, types of cargo, packages and packaging materials; layout key for standard consignment instructions; freight cost codes, a naming system to be used for the establishment of harmonized descriptions of freight costs and other charges related to the international movement of goods; trade and transport status codes; use of the UN/EDIFACT standard; commercial use of interchange agreements for electronic data interchange; pre-shipment inspection; codes for types of means of transport; model electronic commerce agreement; e-commerce self-regulatory instruments (codes of conduct); establishment of single window; data simplification and standardization for international trade; establishing a legal framework for international trade single window.

For a full list of trade facilitation recommendations, please access: **http://www.unece.org/cefact/recommendations/rec_index.html.**

Source: UNECE.

In general terms, and at a minimum, the following interlinked recommendations can be made for governments to facilitate trade:

- Simplify and harmonize trade procedures in accordance with international recommendations such as UN/CEFACT.
- As part of this exercise, adopt paperless trading systems[47] and single window systems.[48] Such single windows can be regionalized within the context of a certain regional integration agreement, such as the ASEAN Single Window.
- Implement the WTO agreements and provisions related to trade facilitation, in particular the WTO Trade Facilitation Agreement.[49]
- Countries may also wish to explore membership of the World Customs Organization (WCO) and become party to its various international agreements and conventions and implement its recommendations.[50]

C. PROMOTING NATIONAL COMPETITIVE ADVANTAGES

1. Creating national competitive advantages as a determinant of foreign direct investment

While FDI can make a potential contribution to national economic development, the development and strengthening of national competitive advantages would provide the best momentum for the development of both domestic private enterprises and attraction of FDI and incorporates both the need for liberalization and deregulation in a sustainable manner and the need for an enabling environment for business and investment. However, strengthening national competitive advantages goes further by incorporating a holistic system of policies for economic development that automatically sends the right messages to foreign investors. At the same time, FDI plays an important role in shaping those competitive advantages.

The development of national competitive advantages defines the specific “product” a country could develop to attract FDI. Where such advantages are not apparent they can be created (Porter, 1990 and 1998). It is therefore important for countries to undertake an in-depth analysis of their actual and potential competitiveness on the basis of which national development plans should be developed, outlining the strategic economic sectors for development and FDI involvement in the long term based on realistic assumptions and within a framework of attainable goals and time frames. To the extent that countries wish to ensure long-term inflows of FDI, governments need to adopt policies to meet the needs of FDI of increasing levels of sophistication. The key policy in this context should be aimed at creating, strengthening and sustaining national competitive advantages. Though the creation of national competitive advantage serves the general purpose of development and goes beyond attracting FDI alone, FDI in both its inward and outward manifestation plays such a key role in the development process, especially for countries at higher stages of development, that a brief outline of the government’s role in creating and sustaining national competitive advantages seems in place in the context of this handbook. The main argument for the government’s role in this process is probably best explained by Porter (1990 and 1998), and will be briefly reviewed in this section.

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[47] At the time of publishing this document, ESCAP member States had concluded negotiations on an Agreement on the Facilitation of Cross-Border Paperless Trade which was opened for signature in October 2016 until 30 September 2017.

[48] According to the World Customs Organization, a Single Window Environment is a cross border, ‘intelligent’, facility that allows parties involved in trade and transport to lodge standardized information, mainly electronic, with a single entry point to fulfill all import, export and transit related regulatory requirements (**http://www.wcoomd.org/en/topics/facilitation/activities-and-programmes/single-window/single-window.aspx**). For more information on single windows, please refer to ESCAP, **http://www.unescap.org/sites/default/files/5%20-%201.%20Introduction.pdf.**

[49] In December 2013, WTO members concluded negotiations on a Trade Facilitation Agreement at the Ninth Ministerial Conference held in Bali, 3-7 December 2013, as part of a wider “Bali Package”. Since then, WTO members have undertaken a legal review of the text. In line with the decision adopted in Bali, WTO members adopted on 27 November 2014 a Protocol of Amendment to insert the new Agreement into Annex 1A of the WTO Agreement. The Trade Facilitation Agreement will enter into force once two-thirds of members have completed their domestic ratification process. The Trade Facilitation Agreement contains provisions for expediting the movement, release and clearance of goods, including goods in transit. It also sets out measures for effective cooperation between customs and other appropriate authorities on trade facilitation and customs compliance issues. It further contains provisions for technical assistance and capacity building in this area. The Agreement entered into force on 23 February 2017. The legal text of the Agreement can be accessed at: **https://www.wto.org/english/tratop_e/tradfa_e/tradfa_e.htm**.

[50] Available from **http://www.wcoomd.org.**

First, competitive advantages are basically created by firms through firm strategy and, as such, the private sector has the most important role to play in creating and sustaining competitive advantages. As countries develop or are proceeding with the transition to a market economy, governments should limit interference with the investment process. Instead the government should focus its economic policy on the goal of "deploying a nation's resources (labour and capital) with high and rising levels of productivity", while policies toward the nation's industry should be aimed at "creating an environment in which firms can upgrade competitive advantages in established industries by introducing more sophisticated technology and methods and penetrating more advanced segments". Governments can shape or influence the context and institutional structure surrounding firms by shaping and strengthening the forces which define the four determinants of national competitive advantage and their interaction.[51] In doing so, government should realize that competitive advantage in industry is relative. Standards for competitive advantage are set not within a nation but by firms in other nations. However, creating and sustaining competitive advantages always entails upgrading of industries through continuous innovation, at a faster pace than in competing industries in other nations.

Second, it appears that a nation's competitive advantages in industries are often geographically concentrated within the nation. As such, the role of local government assumes as much importance, if not more, as the role of central government, in the promotion and formation of industry clusters and promotion and attraction of FDI.

Third, creating competitive advantages takes time, at least a decade or so, and should not be rushed.

Fourth, nations gain advantage because of differences, not similarities. In Porter's words, "each nation has a unique array of competitive industries, and no nation is, or can be, competitive in everything". Where such competitiveness is not present, it can be created. Where product similarity exists with other countries or even within industries, brand name development is extremely important. For instance, most European countries compete in the automobile industry and all produce cars. Their competitiveness lies not in the product but rather in the particular brand. Thus, Germany exports Mercedes Benz and BMW, France exports Peugeot and Renault, the United Kingdom exports Rover and Rolls Royce etc. These cars serve particular niche markets and cater to specific sets of customers. But even with regard to products, competitiveness can, and in most cases, must, be created. It is not evident that Switzerland should have a competitive advantage in financial services, watches or Swiss army knives. Competitive advantages in these industries were created; they did not exist by virtue of country characteristics. FDI can help in creating such advantages while, in turn, the level of competitive advantages would also attract FDI.

Fifth, government policy must provide an environment in which any industry can prosper if firms are innovative and achieve high productivity. Preferably, no prioritizing of industries should take place.

Sixth, governments should not succumb to pressures from some businesses to create an environment of protection and guaranteed government support. Rather, facing the forces of competition on a global scale and investing heavily in upgrading the four determinants of national competitiveness, while pressing for liberalization of a country's export markets (including agriculture) would benefit the country much more in the long run. Creating, strengthening and sustaining national competitive advantages require dynamism with continuous pressures for upgrading and sustained investment. Trade protection would allow the country and the country's businesses to avoid those pressures and hence fall behind industries in other countries which they, ultimately, will have to face in a globalizing world.

There is a wide range of government policies that affect national advantages in some industry or group of industries in some way or another. Education policy, tax policy, health care policy, anti-trust policy, regulatory policy, environmental policy, fiscal and monetary policy, and many others are all relevant. However, most governments suffer to some degree from overlapping authority and inconsistent policies toward strengthening competitiveness of a given industry in different parts of government.

2. The role of science, technology, and innovation in shaping national competitive advantages and sustainable development

Though multiple factors play a role in shaping national competitive advantages, probably nothing matters more than the role of science, technology and innovation (STI). The most competitive countries today are not

[51] These four determinants are: factor conditions; demand conditions; related and supporting industries; firm strategy, structure and rivalry. These factors were explained in chapter 1.

surprisingly also those that are the most innovative benefiting from generally superior education systems and an overall climate conducive to R&D and innovation. Scientific advances and technological change both drive innovation and are driven by it.

Innovation and technology development are also required to enhance the sustainability of products and services, not only in the way they are used (i.e. renewable energy technologies such as solar panels) but also in the way they are produced (i.e. sustainably). STI indeed touches on virtually every proposed SDG and has a cross-cutting role to play in addressing the interconnected challenges of sustainable development and providing effective solutions to the emerging problems of a post-2015 world (Chaisse, 2016).

Countries that are technologically more advanced will be able to attract more sophisticated and technology-intensive forms of FDI that, in turn, will further contribute to the further strengthening of national innovation systems (NIS) in the form of R&D undertaken by TNCs and spill-over effects in the form of skills and knowledge development. It is the quality of these systems that determines the overall level of a country's STI capabilities and national competitive advantage, and ultimately economic development (Fagerberg and Srholec, 2008).

Government policy can and must drive the development of national and subnational innovation systems. As OECD (2000) notes, "companies can no longer cover all relevant disciplines as many key developments draw on a wide range of scientific and commercial knowledge. The need for co-operation among participants in different fields of expertise has become greater in order to reduce uncertainty and share costs and knowledge." Governments can promote cooperation among companies through clusters, science and technology parks, incubators and networking among all stakeholders in an NIS, e.g. academia, research institutes, private sector, foreign investors, and government agencies. A strong legal and regulatory framework that promotes competition and protects IPR is also required.

An NIS refers to the complex and interactive web of knowledge flows and relationships among industry, government and academia and making them work systematically to sustain innovation and science and technology development efforts.[52] The innovative performance of a country depends to a large extent on how these NIS actors relate to each other as elements of a collective system of knowledge and technology creation and use. A successful NIS ensures that not only innovation takes place in accordance with national development priorities, but that it also results in concrete improvement of people's living standards. For the business sector, a viable NIS can provide the necessary environment to make innovations commercially viable and profitable.

Figure 3.1 shows the NIS concept in some details with the inner ring constituting the institutions and policies directly involved in scientific and technological innovation. The outer circle shows a "broad" NIS perspective, which takes into account the economic, social and political environments of the country examined. As STI cuts across the work of various ministries, effective coordination among government ministries and agencies in advancing and mainstreaming STI for development is called for to ensure policy consistency and coherence.

Figure 3.2 shows the NIS in a broader context, highlighting the role of FDI in shaping such systems but also the effect such systems would have on attracting FDI. It also shows the role of a government policy framework that affects the quality of an innovation eco-system characterized by the strong interrelationships and collaboration mechanisms among the principal innovation players, i.e. business, R&D institutes and academia. Such an eco-system has multiple dimensions which affect the quality of the system but can also be influenced by it, such as FDI and the role of TNCs. The government policy framework, in turn, is influenced by a country's history and culture and the international environment including international obligations under international law such as WTO and international investment agreements. Finally, the crucial link between government policy and the innovation eco-system is financing and facilitating and provision of infrastructure. Some financing mechanisms specifically targeting innovation are part of this eco-system (such as venture capital) while the general banking and financial markets system can be directly influenced by governments to increase loans to innovation and technology-oriented firms, in particular start-ups that are routinely categorized as SMEs. With regard to infrastructure, government policy is required to set up science and technology parks, technology-intensive special economic zones, incubators as well as the overall provision of adequate roads, ports, ICT networks and energy supplies (e.g. electricity, oil and gas, etc.). NIS can be national across the board or be developed for the development of a specific sector. A good example of a general NIS is provided by the Republic of Korea (box 3.8). Good examples of a sectoral NIS include the IT-software system developed in India and the development of the Multimedia Super Corridor in Malaysia (box 3.9).

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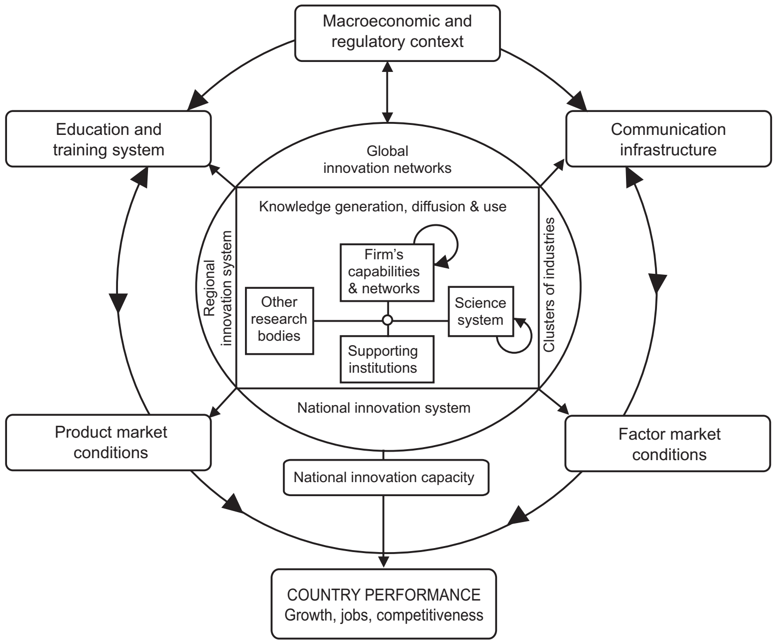
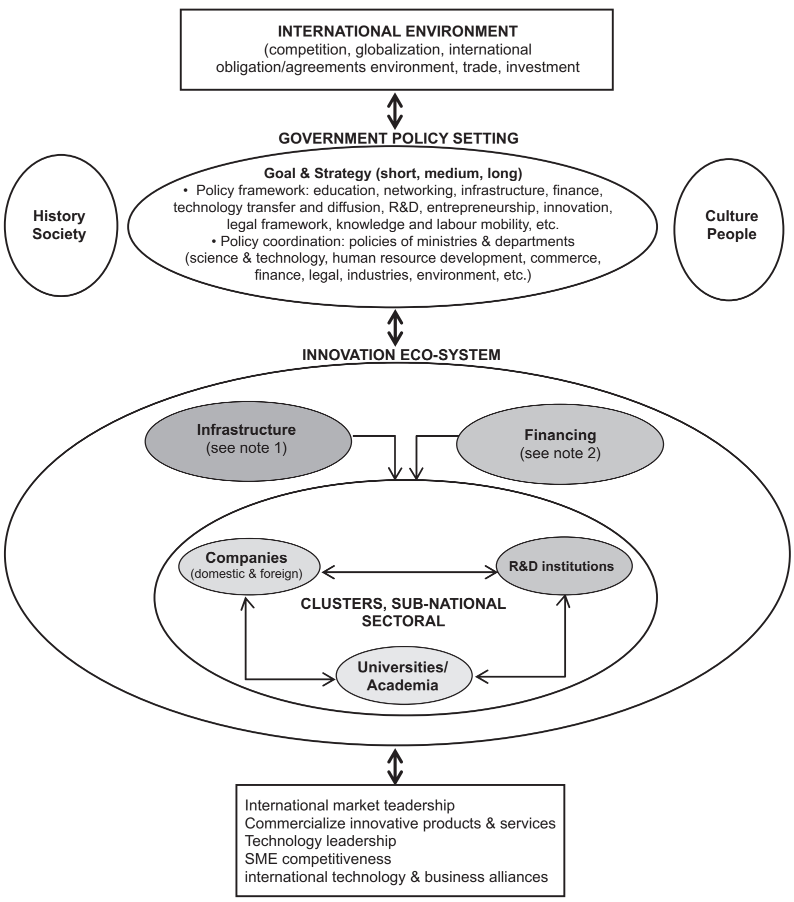
52 Available from **http://www.unescap.org/sites/default/files/Conceptual%20framework%20for%20STI_0.pdf**.

Figure 3.1. National Innovation System: an overview



Source: OECD, *Managing National Innovation Systems*, Figure 4 (Paris, 1999).

Figure 3.2. NIS in a broader context



Source: ESCAP-APCTT.

Notes: 1. Example of infrastructure: electricity, road, rail, ports, telecommunication, science & technology parks, tech business incubator, science & technology info centres, etc. 2. Financing instruments: bank loan, grant subsidy, business angel, venture capital, corporate venturing, crowd funding, tax incentive, etc.

Box 3.8. Development of NIS in the Republic of Korea

The Republic of Korea provides a good example of the development of a national innovation system with early emphasis on the importance of STI in national development, ultimately leading to the success of innovating companies such as Samsung. Since the end of the Korean war in 1953, the country has undergone a remarkable transformation guided by targeted government policy. Though in the early years, the Government focused on the development of labour-intensive industries, institutions such as the Korea Institute of Science and Technology (KIST) and the Korea Advanced Institute of Science (KAIS) were established. By the 1970s and 1980s the focus shifted to heavy industries such as petrochemicals, shipbuilding, automotive manufacturing and consumer electronics and led to the development of the country's major conglomerates or "chaebols". From the mid-1980s the Korean Government's attention was turned to fostering high-technology industries such as semiconductors. This transitioned in the 1990s into more knowledge-intensive industries. Over this time there was significant investment made by the Government in the creation of industrial cities, technology and science parks. A National R&D Programme was launched along with initiatives aimed at helping private companies develop high technologies. It was in this period that the major investment in R&D shifted from the Government to the private sector. By 2007, 80% of Korea's R&D expenditure was occurring within the private sector. This was supported by Government tax incentives for R&D and the importation of foreign technology.

The following policies have been identified as instrumental in turning the Republic of Korea into a knowledge- and innovation-driven economy. The first of these was the fostering of region-specific industrial clusters. These comprised around four strategically important industries in each region, with support from Government at both the national and local level. Regional innovation councils were used to help facilitate the development of these clusters. The second was the creation of environments conducive to the fostering of entrepreneurship and innovation. This included the creation of a business environment that encouraged new business formation and offered stable and transparent legal systems. Quality of life and access to financing, business support services, flexible labour, education and training, plus R&D centres were also features of these initiatives. The third initiative was the enhancement of a collective learning process within innovation networks. This included strategies such as the removal of legal and regulatory obstacles to inter-firm cooperation. Also included were incentives for collaborative research between industry and universities, plus access to professional services and the fostering of social networks. The fourth initiative was the building up of a stock of social capital. This was facilitated via the active engagement of non-government organizations, churches and through social networking forums such as conferences, workshops and seminars. Finally, there was a promotion of local and global networks. This included engagement with other countries such as Japan, Singapore and China in cross-border knowledge exchange for education, research and industry collaboration.

A main lesson from Korean success in building NIS is the close collaboration between government, private sector and academic institutions and strong emphasis on higher education. The main criticism of Korean NIS development is that it focused on the chaebols or large conglomerates at the centre of the NIS and not so much on SMEs. The establishment of WTO in 1995 and the Asian 1997 crisis prompted the Government to restructure the chaebols and focus on the development of an innovation-driven economy, including innovative SMEs. In particular, the Government customized SME policies to meet the objectives differentiated in accordance with the demands and characteristics of SMEs. Major components of government support include the SME Technology Innovation Programme, Industry-University-Research Institute Consortium Programme, New Technology Purchasing Assurance Programme, and the Korean Small Business Innovation Research (KOSBIR) Programme. With regard to financing, the Government provides both direct and indirect financing. For direct financing from the market, the Government promotes the venture capital market. As for indirect financing, the Government provides a credit guarantee service for SMEs ineligible for bank loans due to a lack of collateral. In addition, the Government operates a business incubation programme and customized policy information systems. The Government also helps with human resources development, for instance through the Industrial Technician Selection Programme and the SME Manpower Structure Upgrading Programme. The Government has also introduced certification systems of innovative SMEs and provides benefits for certified innovative SMEs when they participate in governmental programmes. Other programmes include the "Purchase-Guaranteed New Product Development Programme" and the "Production Environment Innovation Tech Development programme." Most of these programmes include funding. Matching funds are also available for SMEs to develop new products with the help of universities, research institutes and other enterprises. If more than two SMEs and a research institute cooperate to create a new product or model in one or two years, they can receive Enterprise Joint Tech Development funds. For details of these programmes, see for instance Kim (2007) and Lilischkis (2011).

Sources: Mazzarol (2012); Kim (2007); Lilischkis (2011).

Box 3.9. Malaysia's Multimedia Super Corridor (MSC)

Malaysia's Multimedia Super Corridor (MSC Malaysia) was established in 1996 by the Government of Malaysia with the aspiration to turn Malaysia into a global hub for ICT and multimedia innovation, operation and services and to transform the country into a knowledge-economy and achieve developed nation status in line with Vision 2020. MSC Malaysia is a Special Economic Zone covering an area of approximately 750 km^2 stretching from the Petronas Twin Towers in Kuala Lumpur to the Kuala Lumpur International Airport, and including the towns of Putrajaya and Cyberjaya. On 7 December 2006, Port Klang was added to the MSC.

The MSC aims to attract companies with temporary tax breaks and incentives, as specified in the Bill of Guarantees, and facilities such as high-speed Internet access and proximity to the international airport. The Multimedia Development Corporation (MDeC) was incorporated in 1996 to oversee the development of the MSC and to advise the Malaysian Government on legislation and policies, as well as to set breakthrough standards for multimedia operations. The MSC helps develop SMEs in the ICT sector and attract FDI. R&D clusters and clusters in other areas such as the Creative Multimedia Cluster have been set up. Incentives are only open to entities with MSC Malaysia statues.

MDeC awards MSC Malaysia status to three types of business entities, each with a set of different application criteria and guidelines, i.e. private limited companies, institutions of higher learning and incubators. MDeC provides seed capital to tech entrepreneurs in the MSC and operates a linkage programme. Its K-workers Development Initiatives (KDI) aims to facilitate the current and future demands of industry-relevant talent by the local ICT industry, especially by MSC Malaysia status companies. Towards this end, KDI offers various programmes encompassing career awareness, skills training, industry attachments, curriculum alignment at Institutions of Higher Learning (IHLs) as well as demand-supply projection. In executing its programme, KDI works closely with relevant ministries and agencies to ensure sustainable, effective and successful implementation. In October 2010, MDeC was given an additional task by the Government, which was to develop a blueprint for a Digital Economy that draws from the huge opportunities created by the Digital world. This resulted in a programme called Digital Malaysia that was officially unveiled to the public in May 2012.

A 2011 study found that MSC Malaysia had made significant contribution to Malaysia's economy and had benefited the ICT industry and the nation as a whole. It observed that a world class environment, facilities and the incentives offered have been successful in attracting FDI and made significant progress towards the country's goal to be a global ICT hub. FDI contributed 60% of total investment during the second phase of the MSC (2004-2010) (Injau, 2011). In the third phase (2010-2020), the MSC will be extended throughout the country. In 2014, over 3,600 companies operated in the MSC of which about 1,000 were TNCs that accounted for 45% of total investments made in that year.

The following factors have contributed to the success of MSC:

1. Comprehensive package for investors;
2. Strong socio-economic and legal-regulatory foundations;
3. Firm commitment from the Government;
4. Proper coordination among relevant government ministries;
5. Open trade and investment regime;
6. Accelerated human resources development;
7. Competitive costs of doing business;
8. Ready access to Asia-Pacific markets;
9. Widespread usage of English language;
10. Excellent quality of life.

Sources: Hamsha Bin Injau (2011); **http://www.mscmalaysia.my**; **http://nurelimtiaz.uitm.edu.my/wordpressfolder-elimtiaz/wp-content/uploads/2012/08/MSC.pdf; http://mdc.com.my/about-us/overview**.

What are the government policies necessary to promote STI, and in particular to establish and strengthen NIS? Policies can be distinguished in various broad categories that are heavily interlinked (OECD, 1997; OECD, 1999; Feinson, 2003; Kaiser and Prange, 2003; Lundvall and others, 2006; Fagerberg and Shrolec, 2008).

- **Education and investment in human capital**: not only is primary and secondary education important here but so is higher learning through universities and vocational training. A strong emphasis on engineering and the natural sciences is required. Scholarships in these areas should be made available on a priority basis and exchange programmes with overseas universities should be actively encouraged. Public-private partnerships have often played an essential role in skills development, for instance in Malaysia where four anchor investors committed equipment and executive teachers to the fledgling Penang Skills Development Corporation (Freund & Moran, 2017).[53]

- **Networking**: Governments need to promote the emergence of networks of innovative firms, which are all part of Porter's determinant of related and supporting industries. Apart from enterprise collaboration activities (both nationally and internationally), networks go further to include academic and R&D institutions to ensure that the results of R&D meet the demands from business and consumers and, hence, have commercial relevance. Networking includes the formation of clusters and removing obstacles to such networks. Governments can assist firms in their search for network partners by providing them with information, brokerage and matching services. Governments can also provide physical space in the form of incubation centres or science and technology parks (e.g. infrastructure, see below). Silicon Valley in the United States is a good example of how such networks can be promoted in a geographically confined space. However, such networks can also be promoted nationally or even regionally.

- **Creation and diffusion of technology and promotion of indigenous R&D**: Governments should not only actively help firms in accessing available technology, they should also provide an enabling environment for firms to engage in R&D and development of technologies with commercially application. National capabilities to undertake R&D and develop new technologies are key to developing national competitive advantages and are a big attraction for TNCs. For instance, the development of India's capabilities in the area of ICT has drawn major global TNCs in the ICT industry to India.

- **Establishment of world-class metrology, standards, testing, and quality control (MSTQ) infrastructure** to ensure that the quality of domestic industrial products meets international standards.

- **Nurture innovation and entrepreneurship culture:** Both firms and governments have a role in undertaking R&D and innovation. Governments often have to address market failures and engage in R&D where the market is not interested (e.g. certain areas of pharmaceuticals). However, generally firms have stronger incentive to engage in innovation if they operate in a fiercely competitive environment (firm "rivalry" in Porter's language). Governments can nurture an innovation mentality by creating the right environment through regulation (see below) and pro-active policies promoting the virtues of (tech-)entrepreneurship and innovation. Governments can also reduce the costs of doing business and lower the entry barriers to start-up businesses.

- **Promoting and mainstreaming open innovation:** The concept of 'open innovation' is being increasingly used as a policy and management tool by technologically advanced enterprises and organizations to sustain and grow in the globalized economy. Open innovation enables enterprises to achieve competitive advantage by combining and utilizing both internal and external ideas and competencies. Through this approach, SMEs and R&D institutes can get vital support to further their innovation capability in many ways: networking and interaction with other companies, sharing R&D facilities, setting up of new technology ventures, partnerships with universities as well as sharing and accessing information and technology.

[53] As reported in Freund & Moran (2017), "To induce multinational investors to upgrade their operations to include more complex tasks, the Penang Development Corporation broadened its investment promotion functions to include the Penang Skills Development Corporation (PSDC), in 1989. With a steering committee headed by Motorola, Hewlett-Packard, and Intel, PSDC induced twenty-four "founder" firms to contribute equipment and assign executives to teach at the new campus financed by the state of Penang. Within seven years – in 1996 – a USAID study ranked PDSC as one of the ten leading Workforce Development Institutions in the world."

- **Free flow of national and international knowledge and flexible labour mobility:** Innovation is most successful in economies where governments promote and allow the production, diffusion and use of knowledge, information and ideas in a free, open and transparent manner. This is particularly important as products and services are becoming increasingly knowledge-intensive. Such knowledge flows also need to take place between the public and private sectors. The free flow of knowledge is further facilitated by free labour mobility.

- **Provide appropriate legal and regulatory frameworks:** Governments need to ensure that the legal and regulatory framework allows for rigorous and fair competition and that the holders and creators of intellectual property are duly protected. IPR protection should be strong enough to accord the necessary protection to domestic innovators and meet requirements of foreign investors in strategic industries but should not be too strong to prevent innovators' access to and use of existing and invented technologies necessary for further innovation. Other legal requirements relate to licensing and acquiring technology, contract enforcement, financing, labour, etc.

- **Provide an enabling infrastructure:** Governments can provide the physical infrastructure for clusters and networks such as incubation parks, science and technology or high-tech parks etc. Malaysia's Multimedia Super Corridor is a good example (box 3.9).

- **Promote technology and innovation financing mechanisms and modalities:** Governments can promote and co-finance schemes that specifically target innovation- and technology-oriented firms such as venture capital. Tax incentives can also be used. However, public support for private R&D needs to be viewed with care as governments are usually not good in picking winners. Where it is considered necessary it should be carefully targeted on the basis of a long-term strategy. It would be better to provide an enabling private sector financing environment where private finance can be effectively mobilized for business investment such as well-functioning capital markets and specialized financial institutions. Governments can also co-finance or provide loan guarantees to other financial institutions and banks to encourage them to lend investment capital to tech start-ups and SMEs with high innovation potential.

- **Maintain open trade and investment regimes:** Liberal trade and investment regimes allow for easier imports of technology-intensive goods and inflows of FDI that may lead to technology transfer provided other components of an NIS are in place. Open trade and investment regimes may also increase the level of competition that, in turn, will foster innovation.

- **Mainstreaming gender in STI:** Gender imbalance is known to exist in STI worldwide with significantly fewer women in primary and secondary schools, universities, laboratories, teaching and STI decision-making. There are also relatively few women in the skilled technology workforce in the private sector, with even fewer females in senior management and as leaders of large companies. Gender mainstreaming in STI through empowering women is being considered as a smart approach to sustainable development.

3. Attracting foreign direct investment to create national competitive advantage

Though the argument is that countries that have developed or strengthened national competitive advantages are better able to attract FDI, countries can use (both inward and outward) FDI to strengthen and expand these advantages. FDI also plays an important role in shaping NIS. It is probably valid to say that countries with no competitive advantages at all would not be able to generate investor interest but at the same time such a situation is fictitious as each country has some kind of national competitive advantage that can be created and/or further developed. Porter (1990, 1998) identified various stages of development in which FDI can play a role. In the initial stages of developing such advantages, i.e. when the country is in the *"factor-driven" stage* of development, FDI can contribute and be attracted in areas such as natural resources exploitation and labour-intensive industries but the impacts of FDI on sustainable development can only be optimized through additional policies governments must put in place. For instance, if host countries continue to rely on rock bottom wages to attract labour-intensive FDI, there will be no wage and productivity growth and, hence, no development. The major contribution of FDI in this stage of development would be to strengthen the factors but as wages rise (as they should) along with productivity, a country enters the *"investment-driven"* stage of development. In this stage, the potential of FDI to further strengthen factor conditions in the country (such as skills and infrastructure) increases. Finally, when a country enters the *"innovation-driven"* stage of development, FDI can contribute through technology transfer, skills development, R&D and brand development. Apart from inward FDI, outward FDI is also important in this

stage as it helps companies investing abroad to tap talent and resources, including technologies, and expand brand recognition beyond the home market. As countries move from one development stage to the next, the contribution of FDI is also expected to increase in a virtuous cycle of development. However, to make this cycle gain momentum and optimize the contribution of FDI to developing national competitive advantage and sustainable development it requires a competent development-oriented government.

Gugler and Brunner (2007) explored the effects that FDI could have on national competitive advantage using Porter's model and concluded that the adoption of a cluster approach would maximize the contribution of FDI to national competitive advantage. Indeed, FDI is part of developing national competitive advantage and Porter himself has been criticized for not taking the issue of "globalization of economic activity" into account in his "diamond" model (Dunning, 1992 and 1993). It is up to governments to adopt the right policy framework that would leverage FDI for national competitive advantage and vice versa, but there is no miracle framework that would fit every country though there are common elements that are presented in this chapter. However, FDI alone is never sufficient to develop national competitive advantage. In the words of Dunning (1992):

"..as producers or consumers, governments may directly affect the supply and demand of both immobile and mobile resources and capabilities affecting competitiveness, they alone have the ultimate responsibility for shaping the framework or system under which resources are organized. They set the "rules of the game" and control the signals that trigger a response by firms, which, in turn, determine whether national competitiveness is advanced or not. Moreover, in a variety of ways, government affect the ability and motivation of citizens and firms (for example, to save, to be entrepreneurial, to work efficiency, to accept new ideas and attitudes and to upgrade human and technological capacity). By affecting exchange rates by participating (or not) in supranational trading schemes, and by their policies and regulations towards FDI, they may influence the extent to which, and the form in which, a country is involved in international commerce."

Table 3.5 summarizes some of the potential contributions FDI can make to the four determinants of national competitive advantage under the right policy conditions which have to be adapted according to the specific development stage a host country is in. The policy suggestions in the table are non-exhaustive.

Table 3.5. Promoting inward FDI for strengthening national competitiveness

Determinant of national competitive advantage	Potential contribution of FDI	Required policy intervention
Factor conditions.	Transfer of knowledge, technology and skills.	Build effective linkages through joint ventures and development of education and vocational training; proper legal framework including IPR.
	Development of infrastructure (roads, ports, ICT, etc.).	Transparent privatization process (including for build-operate-transfer) and solid regulatory framework and implementation of rule of law. Develop frameworks for public-private partnerships.
Market conditions.	Provide employment at higher than average wages.	Ensure the labour force has the required minimum skills; establish minimum wage at realistic levels reflecting productivity; keep labour laws flexible.
	Sale of higher quality (and more sustainable) products which will develop market "taste" of consumers; brand name development (made in...).	Enforce product quality and testing in conformity with international standards; apply proper regulatory framework with strong environmental provisions
Related and supporting industries.	Leading TNCs are often followed by SMEs from their own countries as suppliers thereby contributing to the development of a local supporting industry. However, this may crowd out domestic enterprises.	Implementation of horizontal linkage programmes such as joint ventures; promotion of FDI from SMEs; setting up clusters in specific supply chains in which host countries have competitive advantages.

Table 3.5. *(continued)*

Determinant of national competitive advantage	Potential contribution of FDI	Required policy intervention
Firm strategy, structure and rivalry.	TNCs can bring new management practices and ideas for structural reform. They can affect the structure of whole supply chains and, hence, domestic suppliers. TNCs also can foster competition.	Provide a liberal investment and business climate (avoid protection of domestic enterprises); implement strong competition policy, including competition or anti-trust regulatory framework.

Source: ESCAP.

D. POLICY FOCUS: FORGING LINKAGES

1. Defining linkages

The forging of linkages, in particular backward linkages, with local suppliers, typically small- and medium-sized enterprises (SMEs) has traditionally been an important policy objective of FDI as successful linkages are believed to lead to positive spill-overs. As UNCTAD (2001) notes:

"Domestic suppliers can also benefit from linkages with foreign affiliates. First, linkages raise output and employment in linked supplier enterprises. The indirect effects on supplier capabilities are probably more important. Linkages can be powerful channels for diffusing knowledge and skills between firms. Inter-firm linkages nearly always entail an exchange of information, technical knowledge and skills. Strong linkages can promote production efficiency, productivity growth, technological and managerial capabilities and market diversification in supplier firms. They can often promote exports by linked enterprises and, under the right conditions, domestic firms may develop to become global suppliers and/or TNCs in their own right. The strengthening of suppliers can in turn lead to various indirect effects and spill-overs for the rest of the host economy. Spill-overs can take place through demonstration effects, mobility of trained labour, enterprise spin-offs and competition effects."

In addition, linkages prevent foreign investors from leaving any time soon making them less "foot-loose." Traditionally, the following types of linkages can be distinguished (Altenburg, 2000; UNCTAD, 2001).

- **Vertical linkages**: **backward linkages** (sourcing inputs from local suppliers) and **forward linkages** (using local enterprises as customers either as independents or franchise, e.g. *marketing outlets* such as automobile dealers, gas stations, restaurant chains and *industrial buyers.*
- **Horizontal linkages**: partnerships with local enterprises in competing industries for the joint manufacturing, marketing or development of products and services and linkages with technology partners.

Vertical backward linkages have increased significantly with the rise of global value chains (GVCs) driven by efficiency-seeking FDI. Since the late 1980s TNCs, both inside and outside the Asia-Pacific region, have invested aggressively in developing GVCs helped by national export-oriented development strategies, trade and investment liberalization and conclusion of regional trade agreements (RTAs), integrated logistics systems and the application of advanced information and communications technology. As UNCTAD (2001) notes, for TNCs, the decision to source locally in a host country depends on the cost, quality, reliability and flexibility of local suppliers relative to suppliers abroad. Proximity matters in many sourcing choices. Being near suppliers can make procurement more flexible and easier to negotiate and monitor. However, on the one hand sometimes TNCs do not have a choice but to source locally if they want to avail themselves from preferential market access under specific RTAs that contain rules of origin that mandate local content requirements. On the other hand, there are studies that reveal very limited domestic involvement in various industries, such as the garment apparel industry, due to burdensome rules of origin, while vertical linkages in the extractives industry are mostly absent (Moran, 2015).

SMEs' greater flexibility, adaptability to local economic conditions and capacity to serve orders for smaller quantities have become key advantages which are linked to strengthened national competitive advantages and the overall improvement of the local business and investment climate. Many SME suppliers in Asian-Pacific developing countries have been moving towards higher value-added functions within GVCs, especially in ASEAN (ASEAN Secretariat and UNCTAD, 2014). While enhancing their supply capacity, they provide more products and/

or services with higher quality, thereby becoming increasingly preferred suppliers to lead firms. As they become more integrated into GVCs and gain skills and experience with conducting business across borders, SMEs in Asia and the Pacific begin to attract the interest of foreign investors to form partnerships through horizontal linkages also, such as joint ventures. Joint ventures have often been the preferred modality for policymakers to attract FDI as it was thought that this would offer the best opportunity for spill-overs. However, the experience with joint ventures has often been disappointing as particular success factors were not in place (box 3.10).

Box 3.10. Forging horizontal linkages: joint ventures

A joint venture is a legal organization that takes the form of a short-term partnership in which the persons jointly undertake a transaction for mutual profit. Generally, each person contributes assets and share risks. Like a partnership, joint ventures can involve any type of business transaction and the "persons" involved can be individuals, groups of individuals, companies, or corporations.[54] An international joint venture (IJV) involves partners from different countries and may be known under different names in different countries. In Viet Nam, for example, JVs are part of so-called Business Cooperation Contracts. An example of an IJV is Sony-Ericsson for the development of new generation mobile phones. The stated reason for this venture is to combine Sony's consumer electronics expertise with Ericsson's technological leadership in the communications sector. Sony had global marketing expertise and Ericsson had technology that made it big in telecommunications. Both companies stopped making their own mobile phones. Sony acquired Ericsson's share in 2012 to form Sony Mobile Communications.

Foreign companies often use joint ventures to penetrate an otherwise difficult market and use the local partner for knowledge of local markets and regulations and business practices. Take China, for example. Sony entered into a joint venture with Shanghai Oriental Pearl Group to bypass China's ban on game consoles from 2000 until January 2014, which caused it difficulty in penetrating the Chinese market. The joint venture with the Chinese company helped to market Sony's PlayStation products in the country. GM's venture into the Chinese market is one of the most recognizable in the automotive industry. In 1997, GM formed Shanghai GM and has forged several joint ventures with local producers to sell its vehicles under brands such as Baojun, Jiefang and Chevrolet. Most recently, Jaguar Land Rover concluded a JV with the Chinese company Chery Automobile developing models specifically destined for the Chinese market. The JV was motivated by utilizing Chery's intimate knowledge and understanding of Chinese customers.[55]

Various countries prohibit majority ownership for foreign investors in selected sectors or have markets that are difficult to penetrate without solid knowledge of local market conditions, language, cultures and regulations and connections with local officials (Craig, 2008; PwC Deals, 2012). In Viet Nam, the local partner often contributes land use rights which are not open to foreign investors under wholly-owned subsidiaries. As a result, foreign investors have an incentive to enter potentially lucrative markets through joint ventures with local firms. Another reason is local content requirements to qualify for preferential access under free trade agreements. The success of joint ventures depends on various factors:

- There is mutual understanding that the IJV is a distinct entity, not a subsidiary or branch of any of the partners.
- There is mutual understanding and alignment of the objective of the IJV and responsibilities of the partners.
- There is a high level of trust, respect and courtesy between the partners.
- The local partner is free from government or political interference (linked to mutual trust).
- The local partner has realistic expectations from gaining access to the foreign partners often superior assets, technology and knowledge and intellectual property. Such access needs to be specified in the IJV legal agreement.
- The IJV is voluntary and not a product of a "forced marriage" (because of local legislation for instance).
- Both partners are committed to accord the necessary time and resources to make the IJV a success.
- Both partners have undertaken proper research and planning before concluding the IJV.
- There is more or less equal bargaining power and capacity between the partners.
- There is a clear objective and benefit to be derived from the partnership joining partners with different but complementary ownership advantages.
- The foreign partner maintains a certain strategic direction of which the IJV is an important part.
- Disputes between the parties are to be decided in a third country.

[54] Available from **https://www.law.cornell.edu/wex/joint_venture.**

[55] Available from **http://www.telegraph.co.uk/finance/newsbysector/transport/9684276/Jaguar-Land-Rover-seals-Chinese-joint-venture.html.**

Forbes identifies the following success factors for an IJV:

- Identify strategic logic and drivers;
- Valuate each partner's product architecture;
- Construct an effective operating structure;
- Define the new business model;
- Create an economic system that will work for all;
- Ensure that all negotiations are win-win;
- Shake hands and lock arms[56]

Established global TNCs may prefer wholly-owned subsidiaries or M&As to IJVs because the above success factors are often not in place. By acquiring or merging with a local partner, the foreign investor keeps control over its operations but gains access to the local company's knowledge of local cultures, regulations and market conditions. However, for smaller TNCs the choice is not clear-cut and IJVs may still offer a cost advantage and be lower risk than a merger or acquisition (Craig, 2008). However, often, an IJV results in the take-over of one partner by the other (Stähler and others, 2007).

Source: references quoted in text.

2. Policy options for forging effective linkages

Despite successes, many countries continue to face significant obstacles to forging effective linkages.

OECD (2005) defines the following main obstacles to forging effective linkages:

- Lack of proper *information* on linkage and match-making opportunities (a role for investment promotion agencies).
- Lack of *SMEs capacity* to forge linkages with TNCs (due to lack of skills and adequate standards and issues related to the relative lack of ease of doing business).
- Lack of *TNC willingness* to forge linkages (linkages are only one possible strategy for TNCs to have access to inputs, resources and markets. Inputs can be imported or produced by the TNC itself while markets can be accessed through exports.) This willingness is of course also related to the host country's general attractiveness for FDI.

Proper government understanding of these obstacles is important to formulate the right policies which need to conform to the current development context and realities of countries. Policymakers also need to be aware of the risks associated with forging linkages for proper policy formulation. For instance, foreign investors may actually exploit market weaknesses or protected industries and engage in otherwise uncompetitive practices through their superior bargaining power which also may lead them to demand a disproportionally large share of the benefits of the linkage. In those cases where foreign suppliers follow the lead investor, local suppliers may lose out. All these risks can be managed through proper policy.

In many cases, TNCs operate their own assistance programmes to enhance the capacity of local suppliers or partners. Governments need to create the conditions under which such programmes would yield maximum results and encourage TNCs to implement such programmes. Governments would also need to ensure that any form of linkage, including any programme implemented by TNCs themselves, would conform to sustainable and responsible business practices and contribute to the country's sustainable development objectives.

Governments can encourage the creation and deepening of backward linkages by lowering the costs and raising the rewards of linkage formation for both TNCs and local firms. The objective is not the linkage itself but the contribution of such linkages to positive spill-overs in the form of knowledge, skills and technology. As observed in chapter 2, such spill-overs are not automatic and require complementary government action. Generally speaking, the promotion of effective linkages requires action in a broad range of policy areas including trade policy (tariffs and non-tariff barriers, rules of origin), competition policy, technology policy (and IPR protection), education policy, labour policy, and general development policy apart from FDI policy and all

[56] Available from **http://www.forbes.com/sites/lbsbusinessstrategyreview/2013/11/26/making-joint-ventures-a-strategic-success/#1b0ccac06724.**

associated laws and regulations (UNCTAD, 2001). Domestic local content requirements are generally found to be counterproductive. As Moran (2011) points out, foreign investors are more likely to "generate more extensive and more competitive backward linkages without, rather than with, explicit domestic content requirements." In short, the success of an effective linkage policy depends on the strength of the country's overall national competitiveness as defined by Porter's diamond.

Altenburg (2000) identifies three sets of factors that define successful TNC-SME linkages:

- The existence of SMEs which have the potential to meet high TNC standards;
- The TNC corporate strategy (i.e. efficiency-seeking FDI has the highest chance of establishing vertical backward linkages while market-seeking FDI has the highest chance to establish horizontal linkages through joint ventures;
- The existence and efficiency of a set of supporting public policies.

OECD (2005) presents a general framework for policy to enhance linkages. This framework consists of three main components:

- Information and matchmaking;
- Enhancing the capacity of SMEs and local suppliers;
- Encouraging TNCs to engage in linkages.

These areas are further elaborated in UNCTAD (2001):

- **Information and matchmaking**. This is usually the role of the country's investment promotion agency. They are important for forging both horizontal and matchmaking initiatives (box 3.11). Online platforms can be developed for such purposes (box 3.12).

- **Technology upgrading**. While FDI is often attracted to gain access to technology, it is usually the level of technological capacity of local firms that are a principal determinant in attracting FDI in the first place. With access to technology, local companies cannot be expected to meet the standards and technical requirements of TNCs. Technology transfer as a performance requirement has often proved counterproductive but a proper incentive programme for large and foreign companies to transfer technology can lead to desired results (OECD, 2005; see chapter 5 for a comprehensive overview of the role of performance requirements and incentives). In addition, the strength of local institutions and degree of IPR protection can play important roles in successful technology transfer.

- **Training**. Again, while TNCs provide training programmes, it is the availability of existing skills that are an important determinant for FDI and effective linkages. Training can be encouraged not only by governments but through designated institutions, including private sector organizations and international agencies. As indicated earlier, public-private partnerships can also play an important role (Freund & Moran, 2017).

- **Finance**. Governments can provide finance, tax credits, and credit guarantees to local companies and encourage TNCs to transfer capital to these companies. Both short-term and long-term finance is required. Without proper access to finance, local suppliers cannot be expected to meet the investment challenges required to satisfy the demands from TNCs.

Box 3.11. Successful TNC-SME linkage programmes in Malaysia, Singapore and Thailand

Various countries in the Asia-Pacific region have been successful in establishing effective linkages between TNCs and local suppliers in specific industries, e.g. Malaysia in the electronics sector (mostly in Penang) and Thailand in the automobile industry. The success of these linkages is partly due to comprehensive government support programmes.

In Malaysia, national and state governments offer numerous incentives to encourage linkages between foreign investors and local SMEs. The scope for linkages is one consideration behind the granting of "Pioneer" status which confers generous fiscal incentives. Established investors can benefit from the Industrial Linkage Programme (ILP) and the Global Supplier Programme (GSP), both of which provide incentives to TNCs and SMEs. Under the ILP, investors can claim tax deductions for costs involved in providing support to local suppliers, including training, product

development and testing, and factory auditing to ensure local supplier quality. The GSP is similar in some ways to Singapore's Local Industry Upgrading Programme (LIUP) in that specialists from foreign affiliates are seconded for up to two years to local firms for the purpose of local upgrading. At the state level, the Penang Skills Development Centre encourages local firms to cluster around foreign affiliate customers and also devises training courses when skills gaps are detected, with foreign affiliates providing the necessary expertise.

In Malaysia, a number of local food processors have become successful suppliers to retail TNCs as a result of the ILP. In 2009, Tesco, for instance, relied on Malaysian food processing SMEs for its 31 locations within Malaysia, as well as many SMEs located in other countries. As of 2009, over 70% of Tesco Malaysia's 60,000 products were produced locally, and 60% of the company's suppliers were Malaysian SMEs.

In Singapore, FDI has played an important role from the very start. The early presence of foreign companies generated strong demand for local partners. At the same time, an early focus on developing a healthy SME sector through financial assistance and capability development programmes allowed for TNC-SME linkages to take place more naturally. Of additional importance were government skill programmes to increase the local pool of human capital in engineering, business management and information technology. These efforts ensured that local SMEs had the necessary absorptive capacity to create and benefit from supplier linkages with TNCs. Nonetheless, the Government of Singapore has implemented policies that actively target FDI-SME linkages, in particular the Local Industry Upgrading Programme (LIUP), which was initiated in 1986 by the Economic Development Board.

Since its inception, the LIUP has helped support the transfer of technology, marketing, and business process knowledge from TNCs to domestic SMEs. Under the programme, TNCs are encouraged to "adopt" SMEs in their value-chain, and government support is provided to both parties through three progressive stages of SME development. The first stage seeks to improve efficiency in general SME functions. During a second stage, new products and processes are transferred to the SME. The third stage envisions joint research and product development with TNC partners. Essentially, the LIUP offers various forms of organizational and financial assistance to upgrade vendor relationships. This flexibility ensures that the programme meets the specific needs of the TNC and their suppliers. By the mid-1990s, the LIUP had already recorded many successes. For example, studies by the LIUP found that suppliers in the early years of partnerships with large firms improved productivity by 17% on average, while value added per worker rose by 14%. By 1994, 180 SMEs and 32 buyer firms, including 28 foreign TNCs, had formed partnerships under the Programme (Battat and others, 1996 quoted in UNCTAD, 2011b). Around 70% of these partnerships were concentrated in the electronics industry, which had been prioritized by the EDB. The LIUP continued to expand over the decade, and by 1999, there were 670 local vendors, 30 TNC affiliates, and 11 large local organizations participating. The LIUP was later subsumed by the Partnerships for Capability Transformation (PACT) programme, an initiative of SPRING Singapore (an agency under the Ministry of Trade and Industry) and run by the Singapore Business Federation.

Thailand's Board of Investment (BOI) set up the BOI's Unit for Industrial Linkage Development (BUILD) in 1992 to strengthen the assembler and parts supplier relationship; to promote the development of suppliers, notably SMEs; to increase production efficiency and quality; and to promote cooperation among foreign investors, Thai parts manufacturers and the Government of Thailand towards this end. The programme encompasses five main activities: providing information about subcontracting opportunities, notably via a comprehensive computerized database; matchmaking services for individual firms; technical and management assistance to local suppliers interested in developing subcontracting relationships; provision of detailed technical and market information on establishing supplier industries in areas with high potential; and the organization and coordination of training courses to upgrade the marketing and technological capability of small and medium-sized local suppliers. To date, BUILD has concentrated its activities mostly on information provision and matchmaking services. Two specific activities were launched in 1997: the Vendors Meet Customers Programme (VMC) and the ASEAN Supporting Industry Database (ASID). The VMC Programme was established to stimulate domestic sourcing of parts and components, particularly automotive and electronics parts. BOI acts as a broker to match buyers or assemblers and vendors or suppliers. The programme arranges for suppliers to visit assembly plants. Such visits enable potential suppliers to learn about the product and process requirements of assemblers, while assemblers make contact with potential local subcontractors. It can also be an opportunity for suppliers to agree on strategic alliances or a sharing of orders when the scale exceeds their individual firm's capacity to deliver components to an assembler.

Source: BOI Thailand, MIDA, UNCTAD (2001) and UNCTAD (2011b).

Specific linkage programmes implemented by governments have played an important role in various countries but their success is very country and environment-specific and dependent on the level of political commitment, the strength of and support given to local enterprises, and the establishment of effective public-private partnerships (UNCTAD, 2001). Linkages will only be sustained if they are technically viable and commercially profitable for the firms involved. Governments can support linkages if the officers involved are professionals with the necessary skills and background.

Box 3.12. Myanmar SME Link

One of the main obstacles to effective SME development and value chain integration is the lack of connectivity capacity including access to functioning broadband Internet connection, among other ICT capabilities, that would allow them to engage in effective innovation to enhance their competitiveness, and, as a result, integrate into regional and global value chains. In particular, the development of online platforms that would allow SMEs to access and connect with interested overseas investors, as well as to learn of relevant business opportunities, would be a great help to them.

In that context, the Task Force on Digital Economy under the ESCAP Sustainable Business Network (ESBN) developed such a platform for Myanmar, called the Myanmar SME Link (**www.myanmarsmelink.com**). The Myanmar SME Link is a unique platform that serves as a resource point for SMEs to reduce information asymmetries and to share business connections, resources, capabilities and the knowledge necessary to identify opportunities and develop their businesses. The platform offers an attractive array of services, including business matching, investment opportunities, alliances/JV partnerships, business services and up-to-date business-relevant news and information on participating countries. Connecting country-based SMEs with investors, partners, services providers, chambers of commerce and other non-profit organizations (development agencies, business associations, NGOs, academic institutions), SME Link Platform aims to improve the resources available to SMEs and enhance their ability to integrate with global value chains. Essentially, SME Link Platform creates an ecosystem around SMEs thereby producing a multiplier effect in this key segment of the economy.

Following the launch of the Myanmar SME Link, the platform is being expanded to cover more countries.

Source: ESCAP.

Altenburg (2000) proposes the following measures to develop local suppliers. Supplier development policies should:

- focus on voluntary measures to support the local supplier base rather than to impose domestic-content requirements and market reservation policies;
- be based upon a medium- or long-term vision concerning the envisaged intra-firm division of labour; targets and target groups should clearly be defined, and policymakers should have an idea of what types of supplier relations are conducive to sustainable competitiveness;
- make sure from the beginning that large corporations are involved in and committed to supplier development programmes;
- be coherent, well-coordinated and transparent. There should be one lead agency for supplier development working hand-in-hand with specialized agencies.

In order to enhance the capacity of local SMEs in a coherent and cost-efficient manner, various governments have established programmes to promote “clusters” which include enterprises in supporting and related industries (one of the determinants of Porter’s diamond of national competitive advantage). Clusters allow SMEs to access common financing modalities and technical and technological support (UNIDO, 2001). In forging linkages and setting up clusters, governments need to be aware of the role of businesses in their own country as part of the GVC which is dominated by the foreign investor. The capacity of local companies needs to meet the requirements of the TNC within its global strategy with respect to GVCs. In other words, the products and services provided by local companies need to fit other products and services provided by other companies in other countries within the GVC to arrive at an end-product assembled and/or marketed and sold by the lead TNC. It has therefore been proposed to involve TNCs in cluster programmes and integrate them in clusters for instance within the context of special economic zones (see chapter 5) (Yehoue, 2005).

Where local SMEs fail to meet the standards of TNCs, a successful strategy has often been the attraction of suppliers from the home country of the TNCs as next-tier FDI (Moran, 2015). While these SMEs obviously pose

competition challenges to domestic host country SMEs they would force domestic SMEs to upgrade as a result and enter into joint ventures with them. A good example is the automobile industry in India and Thailand where major Japanese TNCs were followed by their own suppliers from Japan. These next tier smaller supplier TNCs have increasingly entered into JVs with domestic suppliers and in the process upgraded the latter's capability.

It must also be mentioned that vertical linkages between TNCs and domestic suppliers need not necessarily be focused on SMEs. While such linkage programmes are traditionally aimed at strengthening the domestic SME sector and it is true that suppliers to large TNCs are usually smaller in size than the lead TNCs, it has been observed that often the best domestic suppliers are mid-size to large-size domestic suppliers rather than SMEs (Moran, 2015; UNCTAD, 2011b).

As mentioned above, as part of supply-chain management, TNCs often have supplier development programmes which local companies can access. Finally, selected international agencies provide matchmaking programmes such as ITC's Value Added to Trade programme packages solutions which helps SMEs provide a differentiated and value-added offer and address production- and logistics-related difficulties in getting products to market (**http://www.intracen.org/itc/goals/connecting-to-value-chains-SME-competitiveness-diversification-and-links-to-export-markets/#sthash.uAnci3E0.dpuf**); UNIDO's Subcontracting and Partnership Exchanges (SPXs) (**http://spx.unido.org/spx/Default2.aspx**) and UNCTAD's Business Linkages Programme (**http://unctad.org/en/Pages/DIAE/Enterprise%20Development/Business-Linkage-Programme.aspx**).

Subsequent chapters will cover the measures required by IPAs to attract FDI while policies to enhance the capacity of SMEs, including clusters, are comprehensively covered in ESCAP's Policy Guidebook for SME Development in Asia and the Pacific (ESCAP, 2012).

E. THE NEW GENERATION OF INVESTMENT POLICIES: SUSTAINABLE FOREIGN DIRECT INVESTMENT

1. A policy framework for sustainable foreign direct investment

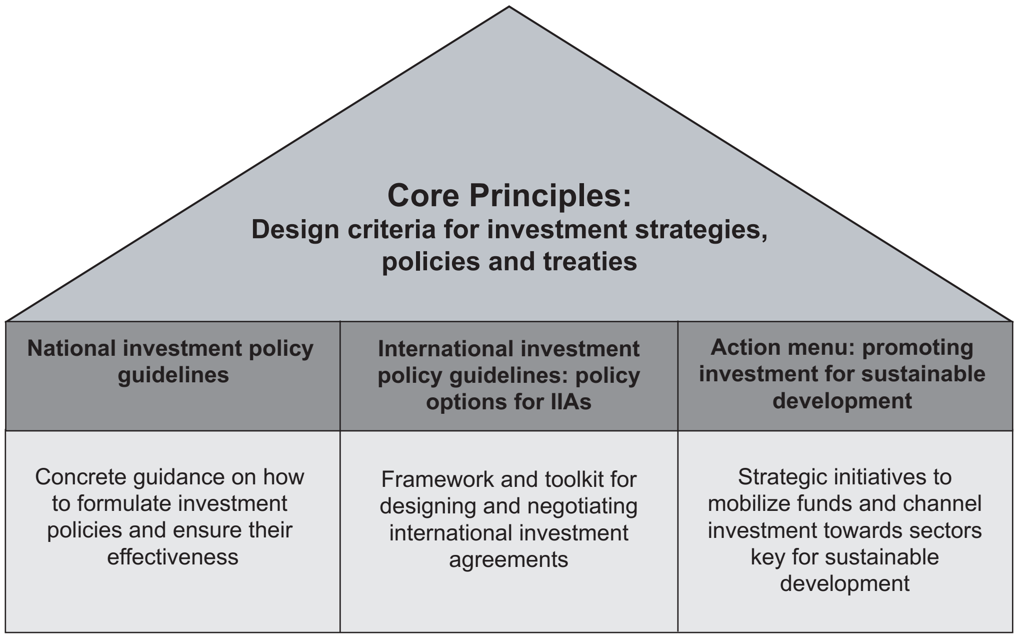
The most recent trend is a shift towards the adoption of "new generation" of investment policies (UNCTAD 2012, 2015). This "new generation" investment policies place inclusive growth and sustainable development at the heart of efforts to attract and benefit from investment giving rise to challenges for investment policy making at the national and international levels. In particular, the new generation of investment policies strives to attract "sustainable" FDI which takes into account environmental, social and governance (ESG) issues (Narula, 2012). "Sustainable FDI" is defined in terms of four dimensions: economic development (linkages, technology transfer, training, etc.); environmental sustainability (minimizing the adverse environmental impacts of investments, mobilizing environmental technologies for conservation, etc.); social development and inclusion (labour and employment standards, community health, education, training, etc.); and good governance (fair and efficient negotiations, absence of corruption, contract enforcement, etc. (see chapter 1).

Sustainable FDI policies are meant to:

- contribute to inclusive growth and sustainable development through the benefits of FDI, i.e. enhance local productive capacities, strengthen social resilience and solidarity, including by reducing inequality, and improving environmental performance;
- create synergies with wider economic development goals or industrial policies, and achieve seamless integration in development strategies;
- foster responsible investor behaviour and responsible business conduct; and
- ensure policy effectiveness in their design and implementation and in the institutional environment within which they operate.

The new generation of sustainable investment policies aims to address potentially negative externalities associated with FDI and requires a comprehensive framework to guide and evaluate FDI projects and government policies on FDI. The creation of measurable indicators would be a helpful step in promoting sustainable FDI. UNCTAD has been at the forefront in promoting sustainable FDI and launched its Investment Policy Framework for Sustainable Development (IPFSD) (UNCTAD, 2012 and 2015). Figure 3.3 shows the essential composition of IPFSD. Box 3.13 lists the core principles of the IPFSD.

Figure 3.3. The components of UNCTAD's IPFSD



Source: UNCTAD, 2015

The new orientation of investment policies requires addressing challenges in investment policymaking at the *national* and *international* levels (UNCTAD, 2012, 2015).

(a) National investment policy challenges

(i) Integrating investment policy into development strategy

- Channeling investment to areas which are considered key for the building-up of productive capacity and international competitiveness;
- Ensuring coherence of investment policy with other sustainable development policies.

(ii) Incorporating sustainable development objectives in investment policy

- Maximizing positive and minimizing negative impacts of investment;
- Fostering responsible investor behaviour/corporate social responsibility (CSR).

(iii) Ensuring investment policy relevance and effectiveness

- Building stronger institutions to implement investment policy;
- Measuring the sustainable development impact of investment.

(b) International investment policy challenges

(i) Strengthening the development dimension of International Investment Agreements (IIAs)

- Safeguarding policy space for sustainable development needs;
- Making investment promotion provisions more concrete and consistent with sustainable development objects.

(ii) Balancing the rights and obligations of states and investors

- Reflecting investor responsibilities in IIAs;
- Learning from and building on CSR principles.

(iii) Managing the systematic complexity of the IIA regime

- Dealing with gaps, overlaps and inconsistencies in IIA coverage and content and resolving institutional and dispute settlement issues;
- Ensuring effective interaction and coherence of IIAs with other international agreements in trade, environment, labour, etc.

Box 3.13. Core principles of UNCTAD's Investment Policy Framework for Sustainable Development

The overarching objective is investment for sustainable development based on 11 core principles:

1. Investment for sustainable development as an overarching goal;
2. Policy coherence: embedding of investment policy in development policies and strategies;
3. Public governance and institutions: inclusive decision-making and rule of law;
4. Dynamic policymaking: periodical reviews for effectiveness and relevance;
5. Balanced rights and obligations between states and investors;
6. Right to regulate in the interest of the public good within international commitments;
7. Openness to investment: open, stable and predictable entry conditions;
8. Investment protection and treatment: adequate and non-discriminatory
9. Investment promotion and facilitation in line with sustainable development;
10. Corporate governance and responsibility in conformity with international standards of responsible business conduct;
11. International cooperation for shared benefits and avoiding investment protectionism.

Source: UNCTAD (2015).

"Investment policy should be based on a set of explicitly formulated policy objectives with clear priorities, a time frame for achieving them and the principal measures intended to support the objectives. These objectives should be the principal yardstick for measuring policy effectiveness." (UNCTAD, 2015)

Goals and objectives for investment policy should adhere to the SMART principle: specific, measurable, attainable, relevant and time-bound.

At the national level, UNCTAD proposes policy action at three levels:

- **Strategic**: embedding sustainable investment policy in the broader economic and social development framework; defining the role of public, private and foreign investment in national sustainable development and ensuring policy coherence.
- **Normative**: setting of rules and regulations to steer FDI towards sustainable development; ensuring proper balance between investment promotion and investment regulation.
- **Administrative**: due implementation of sustainable FDI policies and establishment of appropriate institutional framework for that purpose.

The Policy Framework identifies key sectors for sustainability where FDI could be attracted on a priority basis (table 3.6). A more detailed overview of the IPFSD and a list of specific national policy guidelines can be accessed at **http://investmentpolicyhub.unctad.org/Upload/Documents/FINAL_WEB_POLICY_FRAMEWORK_30_NOV_2015.pdf.**

UNCTAD's Investment Policy Framework, like other similar policy frameworks, has been criticized in that it only covers prescriptions for sustainable FDI at the macro-level but fails to address the need for effective implementation processes at micro-level to encourage FDI that matches host country development needs and priorities. For instance, Kline (2012) observes that it falls short of providing an integrated and applied mechanism for assessing whether FDI meets sustainability criteria. Therefore, there is a need for a process implementation tool that can help evaluate the multiple, interactive effects of an FDI proposal across economic, environmental, social, and governance objectives.[57]

UNCTAD's Investment Policy Framework was followed by an Action Plan for Private Investments in the SDGs (UNCTAD, 2014). The Action Plan contains a Strategic Framework for private investment (not only FDI) in the SDGs and a set of guiding principles to help overcome policy dilemmas associated with increased private sector engagement in SDG sectors. Private investment is needed to address the annual $2.5 trillion investment gap developing countries face for achieving the SDGs. The Action Plan is based on the notion that private sector

[57] Available from **http://ccsi.columbia.edu/files/2014/01/FDI_82.pdf.**

Table 3.6. Key priority sectors for attracting sustainable FDI

Sector	Description
Power	Investment in generation, transmission and distribution of electricity
Transport	Investment in roads, airports, ports and railroads
Telecommunications	Investment in infrastructure (fixed lines, mobile and Internet)
Water and sanitation	Provision of water and sanitation to industry and households
Food security and agriculture	Investment in agriculture, research, rural development, safety nets, etc.
Climate change mitigation	Investment in relevant infrastructure, renewable energy generation, research and deployment of climate-friendly technologies, etc.
Climate change adaptation	Investment to cope with effects of climate change in agriculture (e.g. drought and flood resistant crops), infrastructure, water management, coastal zones, etc.
Eco-systems/bio-diversity	Investment in conservation and safeguarding eco-systems, marine resource management, sustainable forestry, etc.
Health	Infrastructure investment, e.g. new hospitals; research and development of new medicines
Education	Infrastructural investment, e.g. new schools

Source: UNCTAD (2015).

contributions can take two main forms: good governance in business practices and investment in sustainable development. This includes the private sector's commitment to sustainable development; transparency and accountability in honouring sustainable development practices; responsibility to avoid harm, even if it is not prohibited; and partnership with government on maximizing co-benefits of investment. The Action Plan can be accessed at **http://unctad.org/en/PublicationsLibrary/osg2015d3_en.pdf**.

Apart from UNCTAD, other organizations have provided their own policy frameworks for sustainable investment, OECD being perhaps the most prominent one, though these frameworks also limit themselves to addressing macro-level issues only and fail to address implementation issues. It updated its 2006 Policy Framework for Investment (PFI) in 2015 (box 3.14).

Box 3.14. OECD's Policy Framework for Investment

OECD released its revised Policy Framework for Investment (PFI) in 2015. The objective of the Policy Framework for Investment (PFI) is to mobilize private investment - both domestic and foreign investment – that supports steady economic growth and sustainable development, contributing to the economic and social well-being of people around the world. It also aims to advance the implementation of the Sustainable Development Goals and to help mobilize financing for development in support of the 2030 Agenda for Sustainable Development. The Framework is a tool, providing a checklist of key policy issues for consideration by any government interested in creating an enabling environment for all types of investment and in enhancing the development benefits of investment to society.

The Framework considers numerous policy dimensions in an integrated manner, drawing on global good practices including: investment policy; investment promotion and facilitation; trade policy; competition policy; tax policy; public governance; corporate governance; policies for enabling responsible business conduct; human resources development; an investment framework for green growth; private investment in infrastructure; and financing for investment. The Framework helps governments consider these policy areas as a whole, supporting policy coherence in support of economic, social, and environmental goals.

The Framework consists of sets of questions that guide policymakers in the following areas: investment policy; investment promotion and facilitation; trade policy; competition policy; tax policy; corporate governance; policies for enabling responsible business conduct; developing human resources for investment; investment in infrastructure; financing investment; public governance; investment framework for green growth. The full text of the Framework can be accessed at: **http://www.oecd.org/investment/investment-policy/Policy-Framework-for-Investment-2015-CMIN2015-5.pdf**

Source: OECD (2015)

The Group of 20 has established a Trade and Investment Working Group which developed a set of guiding principles for global investment policymaking. Following the meeting of the G20 in Shanghai on the 9th and 10th July 2016 under the presidency of China, G20 Trade Ministers issued a statement reinforcing their determination to “promote inclusive, robust and sustainable trade and investment growth”. At the same time, Ministers agreed on the G20 Guiding Principles for Global Investment Policymaking (box 3.15).

Box 3.15. G20 guiding principles for global investment policymaking

With the objective of (i) fostering an open, transparent and conducive global policy environment for investment, (ii) promoting coherence in national and international investment policymaking, and (iii) promoting inclusive economic growth and sustainable development, G20 members hereby propose the following non-binding principles to provide general guidance for investment policymaking.

I. Recognizing the critical role of investment as an engine of economic growth in the global economy, Governments should avoid protectionism in relation to cross-border investment.

II. Investment policies should establish open, non-discriminatory, transparent and predictable conditions for investment.

III. Investment policies should provide legal certainty and strong protection to investors and investments, tangible and intangible, including access to effective mechanisms for the prevention and settlement of disputes, as well as to enforcement procedures. Dispute settlement procedures should be fair, open and transparent, with appropriate safeguards to prevent abuse.

IV. Regulation relating to investment should be developed in a transparent manner with the opportunity for all stakeholders to participate, and embedded in an institutional framework based on the rule of law.

V. Investment policies and other policies that impact on investment should be coherent at both the national and international levels and aimed at fostering investment, consistent with the objectives of sustainable development and inclusive growth.

VI. Governments reaffirm the right to regulate investment for legitimate public policy purposes.

VII. Policies for investment promotion should, to maximize economic benefit, be effective and efficient, aimed at attracting and retaining investment, and matched by facilitation efforts that promote transparency and are conducive for investors to establish, conduct and expand their businesses.

VIII. Investment policies should promote and facilitate the observance by investors of international best practices and applicable instruments of responsible business conduct and corporate governance.

IX. The international community should continue to cooperate and engage in dialogue with a view to maintaining an open and conducive policy environment for investment, and to address shared investment policy challenges.

These Principles interact with each other and should be considered together. They can serve as a reference for national and international investment policymaking, in accordance with respective international commitments, and taking into account national, and broader, sustainable development objectives and priorities.

The Principles build on UNCTAD’s Investment Policy Framework for Sustainable Development. According to Zhan (2016), the Principles contain key new generation investment policy elements, such as sustainable development and inclusive growth, the right to regulate for public policy purposes, and guidelines on responsible business practice. These are the core elements that are typically weak or absent in most of the existing IIAs. They contribute to strengthening policy coherence between national and international policies and consistency between investment policies and other policy areas, as well as sustainable development objectives. They seek to strike a delicate balance between the rights and obligations of firms and states, between liberalization and regulation, and between the strategic interests of host and home countries. For a broader analysis of the objectives, scope and implications of the Principles, see Joubin-Bret and Chiffelle (2016).

Source: Annex III of the G20 Trade Ministers Statement, 9-10 July, Shanghai: **http://www.g20.org/English/Documents/Current/201607/t20160715_3057.html**.

2. Promoting socially responsible investment

As explained in chapter 1, **socially responsible investment** (SRI) is an important component of sustainable investment, both domestic and foreign and is often used interchangeably with sustainable investment. The term socially responsible investment (SRI) emerged in the early 1990s when the practice of taking social and ethical considerations in the investment decision became more formalized. In its most basic form, SRI is investment activity that factors environmental, social, and corporate governance (ESG) into investment decision-making (ESCAP, 2013). At a minimum, SRI involves negative screening, or not making investments into sectors deemed to have negative social or environmental impacts, such as tobacco, gambling, and defence. Another method of practicing SRI goes beyond negative screening and involves active engagement with company leadership through shareholder advocacy. Under this scenario, investment funds not only screen out certain sectors but also use their shareholder power to proactively try to influence management of the companies they invest in to improve ESG (ESCAP, 2013).

SRI most commonly refers to investment in a fund that invests in shares of publicly traded companies rather than FDI. Each SRI fund defines its own criteria for the application of negative screening and the extent to which it practices shareholder advocacy. It is each investor's choice as to which fund's screening criteria align with his or her values. SRI funds do not differ from other types of funds investing in public securities in terms of their risk profiles. Investors have a range of funds of different risk profiles and sector focuses to choose from, and SRI products are available for retail and institutional investors. Industry associations exist to support SRI, while internationally accepted guidelines exist for both investors and companies to help them consider and report on factors related to social responsibility (ESCAP, 2013).

National level and multinational initiatives and organizations are engaged in promoting and supporting the SRI industry and setting best practices. For example, the United Nations Global Compact principles[58] and Guiding Principles on Business and Human Rights[59] provide useful guidelines for businesses of all kinds to adopt responsible business practices in their operations and investment. However, these principles do not apply to FDI. The United Nations Global Compact-backed Principles for Responsible Investment (PRI) initiative lays out six principles that provide a voluntary framework which enables institutional investors to incorporate ESG issues into their decision-making and ownership practices[60]. Another example is the Global Reporting Initiative (GRI) which provides voluntary standards for uniform reporting on sustainability issues and helps standardize the reporting methodology by companies, including TNCs on ESG issues.[61]

With regard to TNCs, the non-binding OECD Guidelines for Multinational Enterprises[62] are probably the most comprehensive set of guidelines for responsible TNC behaviour. In addition, there are various "multi-stakeholder initiative standards" such as the International Standard Organization (ISO) 26000 standard series on social responsibility.[63] Similar standards exist at the sectoral level, such as the Extractive Industries Transparency Initiative.[64] UNCTAD, FAO, IFAD and the World Bank jointly developed a set of principles for responsible agricultural investment that respects rights, livelihoods and resources (PRAI).[65] Finally, there are numerous industry association codes and individual company codes that also apply to the supply chains they dominate. UNCTAD's World Investment Report 2011 provides an exhaustive overview of the various international standards for Corporate Social Responsibility (CSR) which should apply to TNCs also.

UNCTAD (2011c) notes various challenges associated with these standards:

- Gaps, overlaps and inconsistencies;
- Limited involvement of outside stakeholders in their formulation;
- CSR standards may undermine national legislative efforts and cannot be a substitute for legal provisions;

58 Available from **https://www.unglobalcompact.org**.

59 Available from **http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf**.

60 The United Nations Principles for Responsible Investment website. **http://www.unpri.org/signatories**.

61 Available from **https://www.globalreporting.org/standards.**

63 Available from **http://www.oecd.org/corporate/mne.**

63 Available from **http://www.iso.org/iso/home/standards/iso26000.htm**.

64 Available from **https://eiti.org/standard/overview**.

65 Available from **http://unctad.org/en/Pages/DIAE/G-20/PRAI.aspx.**

- Reporting continues to lack uniformity, standardization and comparability;
- Lack of transparency in some standards makes it difficult for stakeholders to evaluate and compare the performance of different initiatives;
- Weak compliance and high burden on companies
- CSR standards may be interpreted as NTMs to international trade and investment.

Another form of SRI is social investment (made by social enterprises) or **impact investment**. The concept of impact investment emerged from discussions within the social and business sectors throughout the late 1990s and early 2000s on moving from the bifurcated view that non-profit organizations and Governments were responsible for addressing social and developmental challenges, while the business sector was only expected to focus on profit maximization. This thinking eventually evolved to the realization that the business and private sectors could also contribute to the development and social agendas while the social sector could engage with the market and business sectors while pursuing social and development goals. While SRI primarily refers to investment in publicly traded securities, most commonly through SRI funds, impact investment is private placement. Impact investments can be made into a range of legal structures ranging from charities to corporations and can be made through various funding vehicles, including FDI. When a company engages in social or impact investment its goal is not profit for profits sake but to either achieve a specific social or environmental goal without a profit motive or to make profit to generate funds to achieve such a goal (ESCAP, 2013).

Related to impact investment is **social investment**. Social enterprises and social ventures are not legal forms but umbrella terms for organizations using market-based models to create social or environmental impact. As such, social enterprises or social ventures come in many different legal forms, determined by the legal contexts in which they operate. Social ventures can be legally structured as traditional businesses, non-profit organizations, or hybrid forms, for example a non-profit organization that fully owns and controls a business entity (ESCAP, 2013). When a TNC makes a social investment, it is also a social enterprise. A social enterprise is not an enterprise that merely incorporates responsible business practices in its operations but actually exists to achieve a social or environmental goal. It can be for-profit or non-profit. An example of a social for-profit enterprise is the Global Institute for Tomorrow (GIFT) that implements the Global Leaders Programme, a training programme for enterprises, including TNCs, to engage in social or impact investment (box 3.16).

Box 3.16. GIFT and the Global Leadership Programme

The Global Institute for Tomorrow (GIFT) is an independent Hong Kong based pan-Asian think tank focused on advancing a deeper understanding of global issues including the shift of economic and political influence from the West to Asia, the dynamic relationship between business and society, the role of the state and the reshaping of the rules of global capitalism. GIFT accomplishes this through a pioneering approach to executive leadership development and by contributing insights, ideas and advice which inculcate a more honest inquiry into solutions to current global challenges.

Among its programmes is the Global Leadership Programme (GLP). The Global Leaders Programme (GLP) is focused on advancing a more contemporary and unabashed understanding of the drivers of change in the 21st century including among others the impacts of peak population, unpredictable climate change, technology over-reach and the crisis of capitalism. The course asks participants to think critically about business models, pricing, externalities, socio-economic development and the nature of prosperity itself. It is an exercise in honest inquiry linked to practical and original outcomes. As part of the course, participants are sent to a country, typically a developing country, where a field project is located. Participants will be requested to develop a social business model to implement the project and achieve its objective. As such, participants will be immersed in an unfamiliar environment, and have their skills tested on a variety of levels and ability to collaborate effectively across cultures and backgrounds in order to drive a successful outcome. The outcome is typically a business plan. On various occasions, such business plans have actually been implemented though the actual implementation is not part of the course.

Apart from GLP, GIFT operates other courses aimed at executive education. In all its courses, GIFT takes an exceptional approach to executive education, which is not based on management theories borne out of the twentieth century and invariably conceived in elite Western institutions. Such an approach goes beyond simplistic notions about free markets, technology and consumption-fuelled growth and instead recognises new realities of the world. It calls for a rethink of public policy which is more adapted to the demands of our times and business models that fit the constraints of the environment.

Source: Available from **http://www.global-inst.com**.

As yet, social TNCs are rare and most social enterprises are SMEs. However, governments can play a role in promoting both the adoption of responsible business practices or conduct (RBC) and corporate social responsibility (CSR) in all enterprises, including foreign companies operating in the host country, and the promotion of social enterprises and social/impact investment, or – in a wider context – socially responsible investment. No doubt, government actions are essential to creating an enabling environment for private sector development that diminishes risks, lowers costs and barriers of operation, and raises rewards and opportunities for competitive and responsible private enterprises. The challenge for governmental agencies in promoting a CSR agenda is to identify priorities, raise awareness, create incentives and support, and mobilize resources from cross-sectoral cooperation that are meaningful in the national context, as well as building on existing initiatives and capacities. For many developing countries, especially in Asia and the Pacific, there is a significant opportunity for governments to harness current enthusiasm for RBC/CSR among enterprises and assist businesses in taking on a bigger role in social development, particularly under the global demands for responsible business practice. Some key roles which a government can actively choose to engage to support socially responsible investment and the adoption of RBC include (but are not limited to) the following (ESCAP, 2009b):

- **Regulation**. While most responsible business practices are based on voluntary guidelines, principles and standards, regulation levels the playing field for all enterprises, including foreign companies in a host country. This can come in the form of laws, regulations, penalties, and associated measures to control aspects of business investment or operations. Governments at different levels can regulate the behaviour or practice of business by defining minimum standards for business performance embedded within the legal framework; establishing targets for business to achieve; setting up enforcers and inspectorates to oversee business conduct; promulgating codes or laws to confine undesirable business conduct; mandating corporate contributions to community; or imposing license of operation or mandatory environmental-friendly industrial systems. Regulation can set minimum wages and maximum greenhouse gas emissions, or requirements for all businesses to issue reports on CSR and responsible business practices. In India, the Government imposed a mandatory requirement for companies to spend 2% of their profits on CSR (box 3.17).
- **Facilitating**. Through facilitation, governments enable or incentivize companies to adopt responsible business practices, and/or engage in CSR or social/impact investment to drive social and environmental improvements. In many of the approaches reflected under this role, government plays a catalytic, secondary, or supporting role. For example, government may provide tax incentives and penalties to promote responsible business; ensure business can access information needed; facilitate understanding of minimum legal requirements for issues relating to responsible business practice; include CSR elements in related policy areas (such as industrial policy, trade policy, environmental policy, and labour policy); offer capacity building, business advisory services and technical assistance to business when needed; or, support supply chain initiatives and voluntary certification.
- **Brokering**. Governments can combine public resources with those of business and other actors to leverage complementary skills and resources to address issues within a RBC/CSR agenda. Governments can act as a broker in partnering public sector agencies, businesses, civil society organizations and other stakeholder groups in tackling complex social and environmental challenges. Governments can do this by initiating dialogue in multi-stakeholder processes; supporting joint government-industry collaboration in capacity building and developing sectoral RBC/CSR guidelines; engaging stakeholders in standards-setting processes; promoting public-private partnerships for community development; and mobilizing resources. In this role as broker, government can also stimulate the engagement of key actors in a RBC/CSR agenda by, for example, providing funding for research or leading campaigns, information collaboration and dissemination, training, or raising awareness.
- **Warranting**. Lastly, government can provide political support and public warrant of a RBC/CSR concept. In particular, this can be done for specific types of RBC-related initiatives in the marketplace. Warranting can take various forms, including commitment to implement international principles; education or awareness raising programmes; official policy documents; publicity of good RBC practice conducted by other leading companies; specific RBC-related award schemes (such as a National Green Business Award); or, endorse specific pro-RBC indicators, guidelines, systems and standards. Government can also lead by example, through modalities such as public procurement or public sector management practices, or direct recognition of the efforts of individual enterprises through CSR award schemes.

Box 3.17. India's CSR tax

In August 2013, the Indian Parliament passed the Indian Companies Act, 2013 (the "New Act"), which replaced the Companies Act of 1956. One of the New Act's most startling changes – which came into effect on the 1st April 2014 – was to impose compulsory CSR obligations upon Indian companies and foreign companies operating in India. These obligations mainly come in the form of mandatory amounts companies must contribute to remediating social problems. The threshold coverage levels for CSR are low. Companies are subject to the CSR requirements if they have, for any financial year:

- a net worth of at least Rs. 5 billion (approximately $80 million);
- a turnover of at least Rs. 10 billion (approximately $160 million);
- net profits of at least Rs. 50 million (approximately $800,000).*

Companies meeting these thresholds are required to develop a CSR policy, spend a minimum amount on CSR activities and report on these activities, or prepare to explain why they didn't. An entity or business that meets these specified thresholds must spend on CSR activities no less than 2% of its average net profit for its preceding three financial years. Net profit means a company's profits as per its profit and loss account prepared in accordance with the New Act, but excludes profits from a company's operations outside India or dividends received from an Indian company that has itself met its CSR requirements.

All CSR funds must be spent in India. The New Act encourages companies to spend their CSR funds in the areas where they operate, but money cannot be spent on activities undertaken that are part of the normal course of the company's business or on projects for the exclusive benefit of employees or their family members. The New Act requires companies to appoint a Corporate Social Responsibility Committee consisting of at least three directors. The CSR committee is required to recommend a formal CSR Policy. The Act further requires companies to prepare a detailed report, in a particular format, about the company's CSR policy, the composition of the CSR committee, the amount CSR expenditures, and the specifics of individual CSR projects.

The measure has drawn criticism in that it poses significant bureaucratic hurdles for companies. It is also not clear what the implications of violation of the Act are. Secondly, if the Indian company undertaking CSR is a subsidiary of a United States entity, or if its business activities "touch" the United Kingdom, then the U.S. Foreign Corrupt Practices Act ("FCPA") or the U.K. Bribery Act ("UKBA"), respectively, as well as other regulatory laws of these jurisdictions, may apply to the Indian company's CSR payments. This may raise serious issues of compliance and liability. Finally, a compulsory CSR tax does not compel a company to actually adopt responsible business practices but to engage in acts of charity to comply with the law. In many cases, companies can use NGOs to meet their CSR requirements. Of course, it is far more important for businesses to adopt RBC in their business operations and investments. In the end, it is not how the profits are spent but how the profits are made. This is the core of sustainability.

Source: Jones Day, April 2014. *India's New Corporate Social Responsibility Requirements – Beware of the Pitfalls.* For full article see **http://www.jonesday.com/Indias-New-Corporate-Social-Responsibility-Requirements—Beware-of-the-Pitfalls-04-15-2014**.
* Note: exchange rate as of April 2014.

Governments can perform many of these roles simultaneously. The key objective is to provide an enabling environment for business and foreign investors to adopt and implement responsible business practices and/or engage in social/impact investment. More specifically, policies to establish/strengthen such an enabling environment can comprise of (ESCAP, 2009b):

- Creating (consumer) awareness and raising public support for RBC and SRI related concepts and practices, including promotion of sustainable production and consumption practices.
- Establishing an RBC/SRI unit/agency as an overall coordinating unit within the government, as effective RBC policy implementation involves many ministries and government agencies.
- Reforming regulatory frameworks to meet international standards.
- Fostering interaction, consultation and dialogue with stakeholders, e.g. business, NGOs and other key stakeholders.
- Assisting and supporting business in the adoption of responsible business practices through HRD, financial support.

In addition, UNCTAD (2011c) proposes the following policies to strengthen the adoption and implementation of international RBC/CSR standards:

- Encourage and support the development of CSR standards, including through the provision of material support, technical expertise, and mobilizing the participation of relevant stakeholders.
- Support the development of national certifiable management system standards (MSSs). This approach provides enterprises with a certifiable standard to distinguish themselves in the area of CSR.
- Apply CSR standards to their purchasing and procurement policies to promote good business practices on more environmentally friendly products, while being careful to avoid discriminatory practices that would be a form of protectionism.
- Partner with donor states to deliver capacity-building initiatives and technical assistance to local industry and regulatory bodies.
- Promote CSR disclosure and responsible investment, including by stock exchanges.[66]
- Adopt some of the existing CSR standards as part of regulatory initiatives, turning hitherto voluntary standards (soft law) into mandatory requirements (hard law).
- Strengthen the compliance promotion mechanisms of existing intergovernmental organization standards.
- Promote socially and environmentally sustainable inward and outward investment, while avoiding discriminatory practices that would be a form of protectionism, through appropriate incentive scheme.
- Strengthen CSR principles in IIAs.

F. REGIONAL COOPERATION AND INTEGRATION

1. Binding forms of regional cooperation and integration

Regional cooperation or integration can help countries achieve synergies in attracting FDI through common collaboration frameworks which can be **binding** or **non-binding**. Binding frameworks are usually found within the context of regional trade or economic partnership agreements and occasionally in separate regional investment agreements such as the ASEAN Investment Area (AIA) and its successor, the ASEAN Comprehensive Investment Agreement (ACIA). Research has revealed that regional trade agreements (RTAs) do have static and dynamic effects on FDI (Aggarwal, 2008). Where trade obstacles are removed and markets are integrated, various forms of FDI would be attracted, in particular market-seeking FDI, while the potential for intra-group FDI is also enhanced but often limited by other factors. Where trade liberalization results in economic growth, the growth momentum itself would attract FDI. In addition, RTAs often contain provisions on the movement of capital and labour that are potentially attractive to investors. Increasingly, RTAs contain specific chapters or provisions on investment, as well as on IPR and services which cover investment directly (see chapter 4). Those provisions may strengthen the investment climate in all members of the RTA. However, while RTAs may lead to more intra-group FDI, they may not necessarily attract more FDI from non-RTA members. Baccini and Dür (2015) found that preferential trade agreements can lead to investment discrimination because of tariff differentials on intermediary products and provisions that relax investment rules for the parties to the agreement. They also found evidence for the argument that non-members are sensitive to the costs that this investment discrimination imposes on domestic firms and react by signing trade agreements that aims at levelling the playing field. This explains why many non-members of blocs such as ASEAN and NAFTA but with substantial trade and investment interest in the members of these blocs were eager to conclude FTAs with the leading members of these blocs or the bloc as a whole (as in the case of ASEAN, in particular as non-members could find themselves in a situation of reduced competitiveness as a result of trade diversion (as they cannot avail themselves of trade preferences which are for members only) while investors from these countries would lack access to the investment preferences open to members. These investors might therefore reconsider investing in any of the RTA members, unless they would benefit from other benefits such as a larger market or trade protectionism offered by the bloc that would offset any disadvantages posed by the lack of access to preferential (trade and investment) preferences which are open to members only. As RTAs or regional integration agreements in a wider sense differ widely in terms of scope, depth and membership and as there are different types of FDI with different determinants, it also follows that different RTAs have different implications for different groups of investors.

[66] For instance, the Malaysian stock exchange has made CSR reporting mandatory for all listed companies, and the Shanghai Stock Exchange in China has published the Shanghai Environmental Disclosure Guidelines, with which listed companies are urged to comply (UNCTAD, 2011c).

An UNCTAD study found that membership in a regional grouping does not necessarily lead to enhanced flows of FDI but that a country that is a member of an RTA with sufficiently deep commitments in trade and investment would be in a better position to attract FDI (te Velde and Bezemer, 2006). The study also found that countries that have larger economies or are geographically closer to larger countries within the regional grouping can expect a larger increase in FDI as a result of joining an RTA than those of countries that have smaller economies or are located on the periphery. Findings from a study conducted by Blomstrom and Kokko (1997) suggested that that the most positive impact on FDI has occurred when regional integration agreements (RIAs) have coincided with domestic liberalization and macroeconomic stabilization in the member countries. An Inter-American Development Bank (IADB) study also found that common membership in an RIA with a source country increases FDI from that source but that countries that are more open, and whose factor proportions differ more from those in the source country are likely to benefit more as it provided opportunities for vertical integration or linkages across value chains (Yeyati and others, 2003). The IADB study also found that the increase in the size of the market associated with regional integration initiatives contributes to attract more FDI to the RIA as a whole. However, only the countries in RIAs that offer a more attractive overall environment for FDI are likely to be winners in this game.

Generally, benefits from regional cooperation and integration accrue over time as agreements are implemented and often strengthened and regional integration proceeds along various dimensions. As Aldaba and Yap (2009) argue, by deepening economic integration among them, ASEAN member countries can establish a region-wide production base that will attract more FDI and strengthen the existing FDI-trade nexus in East Asia. Aggarwal (2008) also finds great potential for enhanced intraregional FDI flows with enhanced levels of regional economic cooperation and integration in South Asia. Feils and Rahman (2011) found that on average there is an increase in inward FDI in host countries that are members of an RIA and that structural determinants such as the host country’s market size, cultural and geographic distances, and institutional efficiency have a significantly different impact than when the host country was outside the integrated area. In other words, membership of the common economic area is associated with greater FDI flows, with the larger members gaining more. However, while the binding nature of RIAs/RTAs may have certain attractions for investors, RTAs by themselves are not a sufficient factor in most investment decisions (see chapter 4 for a discussion on international investment agreements).

2. Non-binding forms of regional cooperation and integration

While regional integration often involves agreements of a binding nature, regional cooperation to attract FDI can consist of many different forms of a non-binding nature. Often, such cooperation mechanisms may be easier to implement and politically less sensitive. In addition, cooperation mechanisms may not directly target FDI but still have an impact on the attraction of FDI. For instance, Aldaba and Yap (2009) find that regional financial cooperation in ASEAN was more important than regional financial integration and helped the development of national financial systems and reduction of risks in the movement of international capital flows. National financial systems, in turn, play an important role in attracting FDI but need to reach a certain level of maturity before regional financial integration can be considered. Te Velde and Bezemer (2006) point to the importance of the ASEAN industrial cooperation schemes and cooperation in investment facilitation by providing information through portals, databases, publications and databases. Box 3.18 provides more background to the various industrial cooperation schemes in ASEAN to promote intra-ASEAN FDI.

Box 3.18. Promoting FDI among member countries of a regional integration agreement: the experience of ASEAN

Since the establishment of ASEAN there have been efforts to stimulate intra-ASEAN FDI through various industrial cooperation schemes with varying success. The ASEAN Industrial Projects (AIP) and ASEAN Industrial Complementary (AIC) programmes were the earliest attempts at doing this, though their top-down approach proved to be unappealing to the private sector. The AIC programme was expanded into the so-called Brand-to-Brand Complementation Scheme (BBC) and which was intended to enhance vertical FDI across ASEAN member countries. The ASEAN Industrial Joint Ventures (AIJV) approach, which at the Third ASEAN Summit in 1987 was reinforced to allow for deeper margins of preference and more attractive equity schemes, also produced relatively disappointing results, due to a variety of inhibiting factors, including: bureaucratic costs, some confusion in terms of regional and national legal applications and jurisdictions, and lack of active promotion. With the advent of the ASEAN Free Trade Area (AFTA), the margin of preferences in the AIJV scheme became redundant. This gave rise to the establishment of the ASEAN Industrial Cooperation (AICO) Scheme which became operational on the 1st November 1996. It was

a cooperative arrangement to promote and facilitate joint manufacturing industrial activities among ASEAN-based companies to reap economies of scale by providing volume, lower cost of production and efficient utilization of production facilities. Under AICO, the products of a minimum of two participating companies from two different ASEAN countries enjoy a preferential tariff rate of 0-5%. Other incentives include local content accreditation where appreciable and other non-tariff incentives are to be provided by the participating countries.

These programmes were all integrated into the ASEAN Investment Area (AIA), created in October 1998. Rather than merely expanding existing programmes in the new context of AFTA like the AICO, the AIA was designed to enhance a process of FDI policy liberalization, promotion, and, to some extent, harmonization across ASEAN member countries, as well as having certain investment facilitation features. It covered five sectors: manufacturing, agriculture, fishery, mining, and quarrying, as well as services incidental to the five sectors ("Services Incidental").

Finally, the AIA was integrated into the most far-reaching and comprehensive investment agreement of any regional integration grouping involving developing countries, the ASEAN Comprehensive Investment Agreement (see chapter 4). The ACIA is currently an important pillar of the ASEAN Economic Community (AEC) which will provide, if duly implemented, the most conducive investment climate among its member countries to date.

Despite all these attempts, intra-ASEAN FDI has been relatively limited due to the fact that countries are competing for FDI in similar areas. It amounted to only 18% of total FDI inflows into ASEAN in 2014 which made ASEAN the second largest investor in ASEAN with most intra-ASEAN FDI concentrated in the manufacturing and real estate sectors though in 2014, 88% of FDI in the agricultural and forestry sector in ASEAN originated from within ASEAN (ASEAN Secretariat and UNCTAD, 2015). Masron (2013) expressed the concern that the AIA/ACIA concept managed to attract more non-ASEAN investors who subsequently crowded out ASEAN investors and called for "national policies that could help elevate local entrepreneurs to become the ultimate promoters of regional prosperity and stability." Where there are economic complementarities the scope for FDI is clearly larger. That explains why countries such as Malaysia, Singapore and Thailand are major investors in the less developed ASEAN countries such as Cambodia, Lao People's Democratic Republic, Myanmar and Viet Nam. However, economic complementarities emphasize the potential for vertical FDI though the scope for joint ventures and other horizontal linkages involving cross-border business-to-business cooperation remains high.

In order for ASEAN to reap the full benefits from the AEC and attract larger FDI inflows, it needs to be more aggressive in promoting regional physical connectivity, through the development in different infrastructure sectors, in order to reduce logistical costs, ease the movement of goods, expand access to electricity and improve the overall investment-enabling environment.

Sources: ESCAP, ASEAN Secretariat and UNCTAD (2015).

In fact, the cooperation schemes for FDI in the context of ASEAN can be considered a best practice. They were originally specified in the schedules contained in the Framework Agreement on the AIA. The Framework Agreement, in article 6, commits member States to undertake the joint development and implementation of programmes in investment cooperation and facilitation, investment promotion and awareness, and investment liberalization and requests member States to submit action plans for that purpose.[67] While the Agreement makes it binding on member States to implement these programmes, it does not specify the nature and depth of the commitments which are to be worked out in action plans that would be reviewed every two years. The programmes are contained in three schedules which are reformulated in generic terms below as a menu/template for investment cooperation among countries, to be implemented on a binding or non-binding basis within the context of any regional cooperation/integration grouping targeting investment:

Schedule I: Investment cooperation and facilitation programmes. Member countries of any regional cooperation/integration arrangement/grouping shall/could/may take:

(a) *Individual initiative* to –

(i) Increase transparency of each member country's investment rules, regulations, policies and procedures through the publication of such information on a regular basis and making such information widely available;

(ii) Simplify and expedite procedures for applications and approvals of investment projects at all levels; and

(iii) Expand the number of bilateral Double Taxation Avoidance Agreements among member countries.

[67] Available from **http://agreement.asean.org/media/download/20140119040024.pdf.**

(b) *Collective initiative* to-

   (i) Establish a Database for supporting industries and technology suppliers within the group;

   (ii) Establish a collective database to enhance the flow of investment data and information on investment opportunities within the group;

   (iii) Promote public-private sector linkages through regular dialogues with the business community and other international organizations operating within the group to identify investment impediments within and outside the group and propose ways to improve the investment environment of the group as a whole;

   (iv) Identify target areas for technical co-operation, e.g., development of human resources, infrastructure, supporting industries, small and medium-sized enterprises, information technology, industrial technology, R&D and co-ordinate efforts within the group and other international organizations involved in technical co-operation;

   (v) Negotiate, review, or where possible improve a collective Agreement for the Promotion and Protection of Investment, and

   (vi) Examine the possibility of a collective Double Taxation Agreement for the group as a whole.

Schedule II: Investment promotion and awareness programmes. Member countries of any regional cooperation/integration arrangement/grouping shall/could/may:

(a) Organize joint investment promotion activities e.g., seminars, workshops, inbound familiarization tours for investors from capital exporting countries, joint promotion of specific projects with active business sector participation;

(b) Conduct regular consultation among investment agencies of member countries on investment promotion matters;

(c) Organize investment-related training programmes for officials of investment agencies of member countries;

(d) Exchange lists of promoted sectors/industries where member countries could encourage investments from other member countries and initiate promotional activities; and

(e) Examine possible ways by which the investment agencies of member countries can support the promotion efforts of other member countries.

Schedule III: **Investment liberalization programmes**. Member countries of any regional cooperation/integration arrangement/grouping shall/could/may:

(a) Unilaterally reduce and eliminate restrictive investment measures and review their investment regimes regularly towards further liberalization. In this context, member countries may undertake actions to liberalize, among others:

   (i) rules, regulations and policies relating to investment;

   (ii) rules on licensing conditions;

   (iii) rules relating to access to domestic finance; and

   (iv) rules to facilitate payment, receipts and repatriation of profits by investors.

(b) Undertake individual action plans to:

   (i) open up all industries for investment to investors from member countries by *(year/date)* and to all investors by *(year/date) (where relevant* – in accordance with the provisions of this Agreement*)*; and

   (ii) extend national treatment to all investors from member countries by *(year/date)* and to all investors by *(year/date***)** *(where relevant* – in accordance with the provisions of this Agreement).

(c) Promote freer flow of capital, skilled labour, professionals and technology among member countries.

With regard to ASEAN, as of 2009 these provisions have been transformed and integrated into main ACIA articles and therefore, for ASEAN at least, are binding in principle. Article 24 on promotion of investment stipulates that:

"Member States shall cooperate in increasing awareness of ASEAN as an integrated investment area in order to increase foreign investment into ASEAN and intra-ASEAN investments through, among others:

(a) encouraging the growth and development of ASEAN small and medium enterprises and multinational enterprises;
(b) enhancing industrial complementation and production networks among multi-national enterprises in ASEAN;
(c) organizing investment missions that focus on developing regional clusters and production networks;
(d) organizing and supporting the organization of various briefings and seminars on investment opportunities and on investment laws, regulations and policies; and
(e) conducting exchanges on other issues of mutual concern relating to investment promotion."

In addition, article 25 on facilitation of investment stipulates that:

"Member States shall endeavour to cooperate in the facilitation of investments into and within ASEAN through, among others:

(a) creating the necessary environment for all forms of investments
(b) streamlining and simplifying procedures for investment applications and approvals;
(c) promoting dissemination of investment information, including investment rules, regulations, policies and procedures;
(d) establishing one-stop investment centres;
(e) strengthening databases on all forms of investments for policy formulation to improve ASEAN's investment environment;
(f) undertaking consultation with the business community on investment matters; and
(g) providing advisory services to the business community of the other Member States."

Article 25 is milder than article 24 in that, in the case of facilitation of investment, member states shall *endeavour* to cooperate, basically turning a legal obligation into a voluntary effort. Article 26 also refers to an endeavour by member states to enhance ASEAN integration as follows:

"Member States recognize the importance of fostering ASEAN economic integration through various initiatives, including the Initiative for ASEAN Integration, Priority Integration Sectors, and AEC, all of which include cooperation on investment. In order to enhance ASEAN economic integration, Member States shall endeavour to, among others:

(a) harmonize, where possible, investment policies and measures to achieve industrial complementation;
(b) build and strengthen capacity of Member States, including human resource development, in the formulation and improvement of investment policies to attract investment;
(c) share information on investment policies and best practices, including promoted activities and industries; and
(d) support investment promotion efforts amongst Member States for mutual benefits."

In addition, other forms of regional cooperation could be envisaged which help to attract FDI to all member countries of a regional grouping[68].

- Regional FDI incentive schemes;
- Joint R&D and technology development;
- Regional patent filing system;
- Regional technical standards;
- Joint databases on supporting industries and technology suppliers;
- Harmonized competition policies;

[68] See for instance ESCAP. Available from **http://www.un.org/esa/ffd/msc/regionalcooperation/PPT/Ratnayake.pdf**.

- Regional credit/insurance guarantee schemes;
- Regional linkage systems;
- Joint regional investment promotion agency;
- Macro-economic and financial policy coordination;
- Regional currency alignment schemes;
- Regional chambers of commerce (e.g. GMS-Business Forum);
- Regional connectivity in roads, railroads, electricity, broadband etc.

In ASEAN, the (framework) agreements/arrangements on trade in goods, services, movement of natural persons, mutual recognition and others that combine into the ASEAN Economic Community all help to foster a climate conducive to FDI, both from within ASEAN and outside. In general, the broader and deeper regional cooperation (moving towards regional integration) is, the more conducive the investment climate can be expected to be in all member countries of a given regional integration arrangement.

G. SUMMARY: MOST IMPORTANT LESSONS FOR POLICY

This chapter dealt with policy frameworks to attract sustainable FDI. It has become apparent that there is no single policy that attracts or promotes FDI but that a combination of policies is needed across a wide spectrum of economic and social development. Investment policy may be a policy with the specific objective of attracting or increasing the amount of FDI to a certain host country. However, host countries need to be clear why they want to attract FDI, i.e. what is the ultimate objective of attracting FDI within the context of sustainable development? Any policy requires an immediate goal and long-term objective. This objective needs to be specific and clear to all policymakers involved. Based on the objective, a framework of means to achieve the objective can be identified where each means is in effect an intermediate goal with a subset of means to achieve it. As such a policy "tree" of interacting means and objectives can be developed which represent the policy. This can be done for something called an "investment policy". However, again, it must be understood that a whole range of policies affect or influence FDI inflows and, hence, the promotion and attraction of sustainable FDI requires a combination of policies that need to be well coordinated and aligned, including economic policies such as trade, competition, technology, labour, competition, financial, fiscal and monetary policies as well as social and environmental policies, legal frameworks, etc. and any policy that improves the absorptive capacity of host countries to *benefit* from FDI.

A comprehensive policy that seeks to attract FDI is one way to go about it. However, perhaps preferably FDI should be built in and mainstreamed into a wider sustainable development policy/strategy/plan for better results. After all, FDI is not attracted for its own sake, but rather for the sake of overall development or specific components of development. Below are some of the important considerations in formulating policies to attract FDI and benefit from it within the wider context of achieving sustainable development (as defined by the SDGs). Some of the considerations below are derived from lessons derived from UNCTAD's investment policy reviews and World Investment Reports, and others as summarized in various publications, (i.e. Nunnenkamp, 2002; Dupasquier and others, 2012 published by UNCTAD). UNCTAD (2011a) presents an action plan for promoting FDI in least developed countries (box 3.19).

- **State a clear objective of FDI policy**. In essence, the objective obviously is to attract more FDI but the objective should be more *specific* with regard to sector or type (what type of FDI in what sector?), location (city, province, special economic zone), and for what purpose. The wider purpose of FDI attraction may be one of the following:
  - access foreign technologies and skills;
  - close the domestic savings-investment gap;
  - provide domestic employment;
  - undertake privatization in an environment of weak domestic private sector;
  - stimulate domestic competition;
  - improve sustainable business practices;
  - develop domestic infrastructure under public-private partnerships;
  - close balance-of-payment deficits;
  - close government budget deficits;

> **Box 3.19. UNCTAD's action plan for promoting investment in least developed countries (LDCs)**
>
> UNCTAD developed a comprehensive Plan of Action for promoting investment in LDCs. The Plan contains recommendations for both governments and development partners. Some of the highlights of the Plan are the following recommendations for government:
>
> - Both FDI and domestic investment should be promoted in tandem in order to forge mutually reinforcing effects.
> - Strengthen public-private infrastructure development efforts, i.e. a new partnership for infrastructure development. This would require careful liberalization of the infrastructure sectors and the establishment of a well-formulated stable regulatory framework and legal framework for public-private partnerships.
> - Increase investment in technical and vocational education and training.
> - Adopt immigration and work permit policies that enable foreign investors to "kick-start" their operations.
> - Pro-actively promote FDI from SMEs to tap unexploited business opportunities.
> - Tap into the rising pool of impact investors.
> - Develop local business and facilitate access to finance, including credit guarantee schemes.
> - Integrate informal businesses into the formal economy.
> - Continue regulatory and institutional reforms along the recommendations presented in this handbook with the purpose of improving the ease of doing business without compromising sustainable development goals.
> - Establish a meaningful consultation mechanism with investors.
>
> The full plan of action can be accessed at **http://unctad.org/en/Docs/diaeia2011d1_en.pdf**.
>
> *Source:* UNCTAD (2011a).

- gain or expand access to foreign markets;
- strengthen national competitiveness across the board;
- allow domestic SMEs and other domestic enterprises to effectively integrate into regional or global value chains;
- or any combination of the above.

Most of these objectives constitute wider development objectives. In such instances, the attraction of FDI is only one way that can be considered to achieve the objective but not the only one. For instance, while FDI may be attracted to generate employment, other policies, such as trade, education, agricultural, social and enterprise (SME) development policies, among others, would also contribute to employment generation. Therefore, FDI needs to be properly placed in a wider development strategy for any given objective.

- **Conform to the SMART principle**. Any objective of any policy needs to be (see e.g. UNCTAD, 2015):
  - *Specific*: Target a specific area for improvement; identify specific types of FDI for targeting, and specify locations where the FDI needs to be attracted. Further specifications should identify the country and company that should be targeted (see chapter 7).
  - *Measurable*: Quantify or at least suggest an indicator of progress for monitoring and evaluation, i.e. the progress towards achieving the objective should measurable.
  - *Assignable/attainable/achievable:* Specify who will do what in formulating and implementing the policy; make sure the objectives can be achieved within a reasonable time span and available resources.
  - *Realistic:* State what results can realistically be achieved, given available resources. Realistic also refers to expectations which should be based on the current development level of any given host country. An LDC should not have an FDI policy targeting high technology industries for instance.
  - *Time-related*: Specify when the objective/result(s) must be achieved. This can be broken down into short-term (e.g. a year), mid-term (e.g. 2-3 years) and long-term (e.g. 5-10 years). Time-related targets should be based on a country's long-term vision or development strategy/plan.
- **Develop investment policy <u>before</u> the formulation of an investment law**. The policy needs to address the following questions: **who** can invest in the country/location, **where**, and under **what conditions** (Daniel and Forneris, 2010).

- **Pursue due consultation with stakeholders**, including domestic and foreign investors, in the formulation of an investment policy to ensure that the policies meet their needs.

- **Adopt a proper monitoring and evaluation framework** to assess the achievement of policy objectives within a realistic time frame against available resources and budget. Monitoring involves regular consultations and requesting feedback from foreign investors.

- **Establish proper coordination frameworks**. The attraction, promotion and facilitation of FDI require a combination of policies or at least consistency of an investment policy with many other policies. For that purpose, frameworks for proper and effective institutional coordination to ensure policy alignment, consistency and coherence need to be established. Ideally, a single agency or mechanism directly under the Prime Minister's or President's Office should perform such a coordination role with due authority and chaired by the Head of Government (see chapter 6 for a more elaborate discussion). An IPA is normally not suited for such a role as the main role of an IPA is investment promotion, not formulation of investment policy (see chapters 4 and 6).

- **Ensure political and economic stability.** It is difficult to attract FDI in countries with political instability of frequently changing economic policies or fluctuating economic variables such as inflation, exchange rates etc.

- **Upgrade infrastructure on an ongoing basis.** Even in the poorest countries a minimum of infrastructural facilities is required for the most basic forms of FDI. While in principle FDI can be attracted to build infrastructure, this is not so easy and often countries that lack proper infrastructure lack other essential determinants for FDI also.[69]

- **Improve the availability of skilled human resources.** This is an essential aspect of improving absorptive capacity to benefit from FDI. However, building human resources requires a long-term commitment and innovative policies and needs flexible labour laws, strong education and training systems, and flexible entry of foreign workers, experts (e.g. flexibilities regarding mode four of the WTO Agreement on Services) which may be politically sensitive. Public-private partnerships and direct involvement of TNCs in local skills development can also play an important role (Freund & Moran, 2017).

- **Strengthen regional cooperation and integration.** The level of regional integration is emerging as an important modality and determinant for FDI in smaller countries, in particular those that are less and least developed or landlocked.

- **Improve ease of doing business and cut red tape**. Economic and investment liberalization can only go so far as both the efficiency and stability of economic systems and the investment climate need to be taken into account. In this regard, improving the investment climate is not only about liberalization but also about prudential regulation and supervision. In this context, while it should be relatively easy to set up a business and obtain an investment permit, among others, the **strong rule of law**, including due implementation and enforcement of laws, rules and regulations – not only in investment, but in all areas – is essential to ensure that not only countries send the right messages to foreign investors but also that countries have a higher chance to benefit from FDI.

- **Avoid over-reliance on fiscal incentives and reform uncompetitive tax regimes**. The issue of fiscal incentives will be further discussed in chapter 5. Fiscal regimes should conform to the core principles of *simplicity*, *predictability* and the *promotion of development goals*, while ensuring adequate revenue streams to finance public expenditures. UNCTAD's investment policy reviews for instance have revealed that "fiscal regimes are (i) often overly complex and lacking in transparency, thus imposing very high administrative costs both upon investors and tax authorities; (ii) unstable and unpredictable, leading to investor confusion and loss of confidence; (iii) attractive for investors, but may encourage tax engineering, arbitrage and evasion, discourage start-ups and fail to produce sufficient revenue to provide essential public services and address the social and economic needs of the majority of the population; and (iv) not sufficiently targeted to promoting specific development goals, including technological upgrading, job creation and cluster development" (Dupasquier, and others; 2012). See also UNCTAD (2015).

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[69] The ADB estimates that Asia-Pacific will need $26 trillion in investment in infrastructure through 2030. Much of that investment will have to come from the private sector. Available from **https://www.adb.org/news/asia-infrastructure-needs-exceed-17-trillion-year-double-previous-estimates.**

- **Strengthening the legal framework for land rights and ownership to facilitate access to land and transfer of land titles**. Investors highly value ownership of assets, including land. The issue of land ownership is further discussed in chapter 4.

- **Improve institutional effectiveness** as a prerequisite for improving the investment climate**.** As Dupasquier and others (2012) note, governance comprises two components: the design and effectiveness of laws and regulations, and the performance of regulatory institutions in the implementation of these laws. The effectiveness of these institutions is an important aspect of a country's investment climate (see chapter 4).

- **Engage in active and pro-active investment promotion and targeting** which play an important role in attracting FDI. In this regard, **an effective investment promotion agency (IPA)** is required to undertake such a role. Subsequent modules will address the key requirements for an effective IPA and for effective investment promotion.

- **Develop the local private sector** to maximize benefits from FDI. In particular, the development of SMEs and forging of effective backward and forward linkages with TNCs is important in this regard. However, often the best local suppliers are mid-size and large-size companies, not necessarily SMEs.

- **Pursue consistent but sustainable economic and investment liberalization.** Such liberalization is necessary but not sufficient to attract FDI. While foreign investors require an overall open and liberalized economic and business climate, many may prioritize specific determinants such as availability of skilled labour and/or infrastructure. In addition, too much and too quick liberalization may undermine the stability of economic systems and become a disincentive for foreign investors. Recently, more emphasis has been placed on the importance of **trade and investment facilitation** rather than liberalization. An effective economic system, including a conducive investment climate requires both efficiency and stability (see chapter 4).

- **Adjust or adopt policies and regulations that minimize the potential negative impacts and optimize the potential positive impacts of FDI on sustainable development.** While generally speaking the negative impacts of FDI are on the decline, the following potential areas of concern require special attention depending on the type of investment and host country locality:[70]

  - Anticompetitive practices by foreign affiliates;
  - Volatile flows of investment and related payments deleterious for the balance of payments;
  - Tax avoidance and abusive transfer pricing by foreign affiliates;
  - Transfers of polluting activities or technologies;
  - Crowding out local firms and suppressing domestic entrepreneurial development;
  - Crowding out local products, technologies, networks and business practices with harmful socio-cultural effects;
  - Concessions to TNCs, especially in export processing zones, allowing them to skirt labour and environmental regulations;
  - Excessive influence on economic affairs and decision-making, with possible negative effects on industrial development and national security.

H. DISCUSSION ISSUES

1. Why does your country attract FDI? In other words, what are the immediate and long-term objectives of attracting FDI?

2. Has your country undertaken any economic, financial, trade, investment liberalization initiatives? How have these initiatives helped economic growth and attraction of FDI?

3. Does or did your country have a privatization programme? What was the role of FDI in the implementation of this programme? Was it successful? What were the obstacles you encountered in involving FDI in privatization and how did you overcome them?

[70] These areas were first identified by UNCTAD (2003).

4. Which of the four determinants of Porter's model of competitive advantage are the best developed in your country and which ones require more attention? How has FDI helped shape some of these determinants?

5. Do you have a separate FDI policy or do you embed FDI in other development policies? How well is FDI integrated in your national development policies, plans and strategies?

6. Do you consult the private sector, and in particular foreign investors, in formulating FDI policies or policies that impact FDI? What is the mechanism for proper regular private sector and investor community consultation? Could this be improved, not only at the central but also at the local level?

7. How do you rate the quality of your infrastructure system as a determinant for FDI? Are you taking measures to improve it? What role is FDI playing in this regard?

8. Does your government engage in public-private partnerships with foreign investors? How effective are these partnerships? What are the obstacles encountered and what is done to overcome them?

9. Does your country have a national innovation system? How would you rate the quality of that system? What role does it play in attracting quality FDI? What could you do to improve it and what role could FDI play in this regard?

10. Does your country have a business linkage programme to help SMEs integrate into global and regional value chains? What role does the attraction of FDI play in this regard? How successful is this linkage programme and how could you improve it?

11. How do you rate the quality of your human resources? Does this match the requirements of foreign investors in the sectors you want them to attract? What role does FDI play in upgrading the quality of your work force?

12. How many regional integration/trade agreements is your country part of? How has membership in these agreements helped attract FDI? How could these agreements be improved to better attract FDI for sustainable development? Is your country involved in any other regional cooperation programme that covers or contributes to attracting FDI?

13. How do you rate the sustainability of FDI inflows to your country/location in terms of social and environmental impact? What are your policies to improve sustainability?

14. Does your country have any policy to promote the adoption of responsible business conduct/practice or CSR?

15. How do you view the contribution of FDI to individual SDGs and what could you do to strengthen that contribution?

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CHAPTER FOUR

4 INSTITUTIONAL AND LEGAL FRAMEWORK FOR SUSTAINABLE FOREIGN DIRECT INVESTMENT

A. INSTITUTIONAL FRAMEWORK FOR SUSTAINABLE FDI POLICY

1. Investment policy vs. investment promotion

Investment policies are normally formulated and administered by a central government ministry, i.e. the Ministry of Trade and Industry. In some cases, like in Sri Lanka, there is a Ministry of Investment Promotion though principal investment policy is set by the Ministry of Economic Development. In Greater Mekong Subregion (GMS) countries such as Lao People's Democratic Republic and Viet Nam, investment policy is determined by the Ministry of Planning and Investment. But other ministries may determine investment policy in their respective areas, i.e. transport, ICT, mining, energy, etc. In addition, the ministries of labour and environment would always be involved with respect to labour issues and environmental screening of investment projects while the Ministry of the Interior or Land would deal with land access issues and the Ministry of Tourism would deal with FDI in the tourism sector. The same ministries involved in policymaking are also the principal agencies in regulation, i.e. determining what foreign investors can do and cannot do. In addition, investment policy often includes special taxation provisions, arrangements for work permits for expatriate staff, restrictions on the purchase of land and foreign exchange arrangements, each of which is the responsibility of different arms of government (Ministry of Finance, Ministry of Labour, Ministry of Lands, Central Bank etc.). Finally, with the existence of special economic zones (including export processing zones), zone authorities may also undertake investment promotion activities and set policy with regard to foreign investors in those zones.

Given the involvement of so many government bodies in setting investment policy, there is an obvious need for policy coherence and consistency through proper coordination, preferably through a body chaired by the head of government of state to give it proper authority. In practice, the absence of proper coordination is a significant obstacle to consistent investment policy formulation and implementation. Such coordination is not only required for bodies that are directly involved in formulating investment policy but also with bodies that set policies that affect investment, i.e. trade and finance, in particular as increasingly free trade agreements have investment and finance chapters and/or provisions. Lastly, in relatively large countries, local government authorities often have considerable freedom to set their own investment policies which are not always in line with central government policy. A case in point is the existence of many "departments of planning and investment" in individual People's Committees at the provincial or municipal level in Viet Nam that set investment policy/regulations for their respective localities, which are not always in line with central government policy set by the Ministry of Planning and Investment in Hanoi (see box 8.9 in chapter 8).

Investment policy is usually separated from investment promotion (see boxes 4.1 and 4.2 for country examples). Most countries have set up agencies that specifically engage in investment promotion and facilitation activities, i.e. investment promotion agencies (IPAs). IPAs are often created through special legislative acts. These acts specify explicitly the IPA institutional structures and functions vis-à-vis FDI promotion and set the broad parameters for the types of activities they can engage in. Given the evolving role of the IPA, the question arises as to what its role should ideally be with regard to investment policy, regulation, promotion and facilitation.

Ideally, not one agency could and should perform all these functions. Investment policy and regulation are very distinct from investment promotion and should therefore be handled by different institutions. The World Bank has cited findings from research that the most successful IPAs do indeed not have a regulatory function, including the screening and approval of investment projects as this may lead to a conflict of interest with the core function of the IPA, i.e. promotion and attraction (see chapter 6 for an in-depth discussion of the role of the IPA). In addition, regulation and promotion require different skills. In case the responsibilities of the IPA change, it would also be easier to amend a specialized IPA act rather than a comprehensive investment act. Hence, the regulation of FDI had better be undertaken by a responsible line ministry rather than by the IPA (Daniel and Forneris, 2010). Where the two functions are combined in one agency they can still be separated (Griffin et. al, 2011). A good example of an IPA focusing on investment promotion is provided by Nicaragua (box 4.3.). Table 4.1 lists the divergent needs of investment promotion and investment regulation

Table 4.1. Divergent needs between the promotion and regulation of FDI

Institutional dimension	Investment promotion	Investment regulation
Organizational culture	• Customer-oriented; • Private sector focus and mentality; • Concerned with priority industries.	• Compliance-oriented; • Administrative focus; • Concerned with all FDI.
Staff skills	• Marketing and sales; • Project and customer relation management; • Communications.	• Administration; • Legal and financial issues; • Precision and thoroughness.
Knowledge	• Business practices; • Sector expertise and competitiveness; • Laws, regulations and procedures; • FDI data; • Foreign languages and business cultures.	• Laws, regulations and procedures; • FDI data.
Enabling environment	• Flexibility within set parameters; • Fast approvals and delegated authorities to permit rapid responses to investor needs; • Outcome-driven.	• Fixed procedures and approval mechanisms; • Supervision and audit; • Process-driven.
Internal systems	• Tailored approaches (using defined methodologies); • Quick, flexible responses to investor needs; • Follow-up until investor is satisfied.	• Standardized systems; • Investor requests are met at the speed of the system; • Follow-up with investors only as required.

Source: Griffin and others (2011), table 1.

Box 4.1. Investment policy and promotion institutions in various countries

Most countries have different institutions for investment policy formulation and investment promotion. In addition, separate authorities often exist that manage special economic zones and engage in investment promotion in those zones. With particular focus on industry and manufacturing, the following institutional frameworks can be observed in various Asian and Pacific countries. In **Afghanistan**, the High Commission on Investment (HCI) chaired by the Minister of Commerce and Industries is the main investment policy making body while the Afghanistan Investment Support Agency (AISA) is the principal IPA for both domestic and foreign investment and was recently integrated into the Ministry of Commerce and Industry.

In **Armenia**, investment policy is formulated by the Department of Investment Policy of the Ministry of Economy. The Armenian Development Agency is the formal IPA though private consultancy companies for investment promotion also exist. In **Azerbaijan**, the Ministry of Economic Development sets overall FDI policy while the Azerbaijan (State) Investment Company undertakes active investment promotion in the non-oil sector. In addition, the Azerbaijan Export and Investment Promotion Foundation (AZPROMO) is a joint public-private-initiative with the aim to contribute to the economic development, inter alia through attracting foreign investments in the non-oil sectors.

The Ministry of Taxes acts as a one-stop shop for foreign business registrations. In **Bangladesh**, no specific institution or ministry is responsible for a core FDI policy and investment policy is subsumed in overall national development and poverty reduction policies and strategies. Investment approvals are made by the relevant ministry. The Bangladesh Board of Investment undertakes both a regulatory and promotion role (UNCTAD, 2013a), while the Bangladesh Export Processing Zone Authority (BEPZA) also plays an important role in investment promotion.

In **Cambodia**, principal FDI policy is formulated by the Council for Development of Cambodia (CDC) while investment promotion activities are the responsibility of the Cambodia Investment Board under CDC. In **China** investment policy is formulated by the Ministry of Commerce which allows for policy coherence in trade and investment while investment promotion is carried out by the China Investment Promotion Agency and its subnational agencies.

In **Fiji**, Investment Fiji is the official IPA under the Economic Development Board and undertakes regulatory functions, promotional activities and advisory and information services. It also acts as a liaison between Government, the private sector and regional and international agencies. In **Georgia**, the Ministry of Economy and Sustainable Development formulates overall FDI policy and oversees the Georgia National Investment Agency, which is the official IPA and acts as moderator between investors and the Government.

In **India**, investment policy is formulated by the Department of Industrial Policy and Promotion of the Ministry of Commerce and Industry which recently issued a consolidated FDI policy that also outlines the functions of India's IPA, the Foreign Investment Promotion Board.[71] **Indonesia** has streamlined investment approval procedures through a one-stop integrated service. Administration and promotion of investment is vested in the Indonesian Investment Co-ordination Board (BKPM), while a National Team on Export and Investment Promotion has been formed to advance reforms. However, as OECD (2010) notes, "local investment promotion agencies vary in capacity, and decentralisation of power has led to uneven policy implementation."

In **Kyrgyzstan**, the Ministry of Economy is the coordinating body for FDI policymaking with line ministries responsible for FDI policy in their respective areas. Foreign investors must register their firms with the Ministry of Justice. In 2010, the Government set up the Council on Development of Business and Investments to advice on policies to improve the business and investment climate. In 2014, the Investment Promotion Agency was established under the Ministry of Economy. In **Lao People's Democratic Republic**, investment policy and promotion are undertaken by the Investment Promotion Division/Department of the Ministry of Planning and Investment, including a one-stop service unit.

In **Malaysia**, the main ministry responsible for FDI policy within the context of broader industrial policy is the Ministry of International Trade and Industry (MITI), which oversees the Malaysia Industrial Development Authority (MIDA). MIDA undertakes both an investment regulatory and promotion role. A Foreign Investment Committee to screen investment projects was abolished in 2009.

In **Papua New Guinea**, the Investment Promotion Authority performs the following roles: business registration, regulation and certification; investor servicing and export promotion; IPR protection; and regulating capital markets. In the **Philippines**, the Board of Investment is the lead government agency responsible for the promotion of investments in the Philippines under the Department of Trade and Industry which sets overall investment policy.

In the **Republic of Korea**, the Ministry of Trade, Industry and Energy is the central government ministry responsible for FDI policymaking. The Ministry oversees the Korea Trade-Investment Promotion Agency (KOTRA) that, in turn, operates Invest KOREA as the official IPA offering one-stop service.

[71] Available from **http://dipp.nic.in/English/Policies/FDI_Circular_2014.pdf**.

In **Thailand**, the Ministry of Industry is responsible for creating an enabling business and investment environment but the Thailand Board of Investment (BOI), established under the Prime Minister's Office, has a main responsibility in formulating and carrying out investment policy based on the National Economic Development Plan (which is designed by the National Economic and Social Development Board under the Office of the Prime Minister) and overall investment promotion and facilitation measures, including the granting of incentives. The BOI also plays an important role in investment policy advocacy.

In **Sri Lanka**, the Ministry of Industry and Commerce does not engage in setting investment policy which is undertaken by a special but junior Ministry of Investment Promotion though the Ministry of Economic Development has more authority in setting investment policy. Effectively, investment policy is formulated and implemented by the Sri Lanka Board of Investment which also undertakes investment promotion activities. However, the Trade and Investment Policy Department of the Ministry of Finance also assists in inward FDI policy formulation and reviewing of the BOI and non-BOI investment policy regimes. In **Viet Nam**, the principal ministry for formulating FDI policy is the Ministry of Planning and Investment which oversees the Foreign Investment Agency as the official IPA. People's Committees at subnational level also tend to have specific departments on planning and investment issuing local regulations and policies for FDI.

Source: ESCAP online research, various national IPA websites.

Investment promotion is a distinct function which requires an agency that works directly with investors. Investors will not take such an agency seriously if the agency also acts as policeman or sets the rules and policies. Investment promotion officials need to gain trust from investors and act as trouble shooters. In essence, an IPA is an investment facilitation agency though it performs an important marketing role as well. Since investment policy is part of so many government agencies, it is unlikely that only one agency such as an IPA could be an effective investment policy body. It would never have the necessary authority even if it directly reports to the Head of State. IPAs therefore also should not normally be involved in investment project screening – which is a function of regulation – though lessons learnt can turn IPAs into policy advocacy bodies. It also means that IPAs rarely are effective "one-stop" shops as the various ministries and agencies involved in investment policy and regulation are unlikely to yield authority to one agency (see chapter 8). However, IPAs can facilitate access for investors and are really meant to attract investors and help them realize their investment, not regulate them.

Box 4.2. FDI policy and promotion institutional framework in Kazakhstan

As Kazakhstan is a landlocked country heavily reliant on the export of oil and gas, the Government's Programme for Accelerated Industrial Development, part of its "Road Map for Business 2020," has created investment priorities aimed at diversifying Kazakhstan's economy. The country's Programme for Investment Attraction, Special Economic Zone Development and Export Promotion in Kazakhstan for 2010-2014 aimed to increase domestic and FDI in non-primary sectors by at least 15% by the end of 2014 and increase the share of FDI in GDP to 5%. The Government adopted a "National Plan for Attracting Investment" in December 2011 which seeks to improve the investment climate by simplifying visa procedures, customs clearance, and transit across borders, as well as establishing special service centres for foreign investors under regional municipal authorities. In 2012, every regional government set up an Investors' Service Center. The central FDI policymaking institution is the Ministry of Investments and Development. The Ministry has an Investment Committee which also houses an Investment Ombudsman. In addition, the Ministry has an Investors' Support Center at the official IPA: Kazakh Invest (successor of the National Agency for Export and Investments or Kaznex Invest).

In addition, by order of the President, the Foreign Investors' Council (FIC) was established an advisory body to promote direct dialogue between the Government and foreign investors in order to efficiently address key issues related to their investment activities in the country, to improve the investment climate of Kazakhstan.

Kazakh Invest is the sole national agency in charge of investment promotion and attraction in Kazakhstan with a wide range of responsibilities to assist foreign investors in their establishment and operations in the country but there are various others that offer support to foreign investors. In particular Kazakh Invest performs the following role (**http://invest.gov.kz/pages/about**):

- a single negotiator representing the interests of the Government of Kazakhstan when discussing the prospects and conditions for the implementation of investment projects

- a single point of access to the system of public services, including both state support for investors in the form of investment preferences, and issuing various permits and approvals necessary for the implementation and further operation of investment projects.

While the institutional framework for investment policy and promotion looks impressive there is a risk that too many institutions with overlapping responsibilities may lead to costs that do not justify the benefits while creating confusion for foreign investors (OECD, 2012). There would be scope for streamlining and consolidating the institutional framework.

Source: ESCAP online research.

For similar reasons, IPAs are ill-quipped to take on a policy coordination role as they are not investment policy bodies. However, where IPAs have been granted sufficient autonomy and authority and their Board is chaired by the Head of State or Government, IPAs can potentially perform a coordination role. The Malaysian Industrial Development Authority (MIDA) and the Singapore Economic Development Board (EDB) are examples of more comprehensive investment policy and promotion agencies which can only function effectively in political systems characterized by centralized policy formulation and control.

Box 4.3. Separating investment promotion from investment regulation: the case of Nicaragua

PRONicaragua, Nicaragua's IPI, exemplifies the dedicated promoter model. The agency was created in 2002 as a public-private enterprise, independent of regulators, and reporting directly to the office of the president, with a mandate to promote economic growth and job creation by providing foreign investors with information, site visit assistance, and facilitation of government contacts.

With an emphasis on achieving best practices to attract and retain FDI, by 2010 PRONicaragua had supported investment projects worth $700 million that could create 49,000 jobs once fully implemented. Nicaragua also has a separate one-stop shop – part of the Ministry of Industry and Commerce – that handles FDI-related regulatory functions such as company and tax registration. The benefits of keeping regulatory functions out of the IPI are reflected in PRONicaragua's specialized staff and closeness to both the private and public sectors. The agency's 25 staff members were hired for their language skills and experience with industries targeted for investment promotion. And while the private sector representatives on PRONicaragua's board help keep the agency attuned to the concerns and expectations of potential investors, public sector board members and the direct channel to the presidency give PRONicaragua the political backing it needs to support investors in the country.

Source: Griffin and others (2011).

At the global level, the World Association of Investment Promotion Agencies (WAIPA) was created in 1995. It was established as an Association under Swiss law. It has been registered in Geneva, as a non-governmental organization and is in the process of being filed with other relevant authorities. From its very inception, WAIPA has represented an ever-growing number of Member agencies. Currently WAIPA has 170 Members from 130 countries. Through its wide range of activities, WAIPA provides the opportunity for IPAs to network and exchange best practices in investment promotion. It provides a useful list of the world's IPAs that are a WAIPA member. It website can be accessed at **http://www.waipa.org**.

2. Investment vs. trade promotion

Given the strong linkages between trade and investment, and the need for coordination between trade policy on the one hand and investment policy on the other hand, some countries have set up combined trade and investment promotion agencies following ministries which cover both trade and investment policy. The track record is mixed. Generally, trade and investment policy can be combined in one ministry though often there is a Ministry of Trade separate from a Ministry of Industry. Though for small countries with small budgets it is tempting to combine trade and investment promotion in one agency as well, in practice both (a) have different objectives; (b) have different skills requirements; (c) work with different sorts of clients in different countries (trade promotion targets the promotion of an export product in a large overseas market and the product leaves the country while investment promotion targets the attraction of individual investors who will enter the country); (d) apply different marketing tools (Sader, 2002). In addition, investment promotion requires decision making at higher levels as it involves foreigners (and their products and services) entering the country and takes place over

a longer time horizon. Perhaps most importantly, investment "promotion" agencies focus mostly on investment facilitation, including aftercare, which is not a function of trade promotion. Therefore, it is generally not advisable to combine trade and investment promotion in one single agency, though understandably, there should be a functioning coordination mechanism between the two separate agencies and their respective policymaking and regulatory ministries.

However, in view of the emergence of global value chains, experience shows that successful joint organizations may be able to benefit from some partially integrated functions, for example administration and technical areas, such as research, image building and overseas representation (UNCTAD, 2013b). Also, to the extent that FDI is export-oriented, helping foreign investors and their local suppliers export more is a key economic development objective and, in this regard, some merging of investment and trade promotion may be useful.

B. THE NATIONAL LEGAL FRAMEWORK FOR SUSTAINABLE FOREIGN DIRECT INVESTMENT

The legal framework for FDI provides the overall institutional and policy framework. Policies and institutions are issued based on adopted laws and regulations. Therefore, policies and institutions cannot be viewed in isolation of the legal framework. Investment policies need to be formulated before investment legislation. Investment legislation "translates" the policy into legal terms that are actionable including in a court of law (Daniel and Forneris, 2010). It is therefore important that the policy is clear to ensure an effective law-making process. The legal framework will provide the legal basis for policies and institutions. Each phase of the FDI cycle has specific legal issues:

- **Pre-Establishment:** Restrictions on investment sectors; restrictions on business structures; difficulties of carrying out a risk analysis in accordance with Western standards.
- **Establishment (entry and locating procedures):** Tax planning and concessions; incorporation and registration, incentive approval, visa and work permits, licensing requirements; capital requirements; collateral and land use rights.
- **Operational:** Labour law; repatriation of profits; antitrust and competition issues; tax reporting and inspections; fire, health and safety inspections; technical standards and certification; import-export procedures; corruption and liability for bribes.
- **Termination:** Termination by authorities; termination procedures; insolvency issues; recovery of intellectual property.

In a modern market economy, the legal framework for FDI encompasses many laws, rules and regulations, that are either specifically designed for FDI or have a direct or indirect impact on FDI. For instance, a law that sets up an IPA is specifically designed for FDI while labour laws and environmental laws are not, though they have a direct impact on FDI and the behaviour of foreign investors in the host country. The national legal framework is also affected by obligations stemming from international legal frameworks such as International Investment Agreements (IIAs) and trade/comprehensive economic cooperation agreements containing investment provisions (see below). It is important to emphasize that these international provisions are part and parcel of domestic law and in case inconsistencies prevail over domestic law. Generally, the following laws are common to a national legal framework for sustainable FDI:

- (Foreign) investment law and regulations, including laws required for FDI institutional framework (e.g. IPA establishment), performance requirements and incentives;
- (Intellectual) property law and regulations;
- Enterprise (company) law and regulations;
- Contract law and regulations;
- Land law and regulations: access/ownership of land (own or lease); land use rights;
- Labour law and regulations (including minimum wage);
- Foreign exchange law and regulations;
- Financial laws and regulations;
- Tax laws: consumption, VAT, business, profit, income, incentives, etc.;
- Insolvency and bankruptcy laws;

- Trade law and import/export regulations;
- Competition law and regulations;
- Environmental laws and regulations;
- Laws related to corporate social responsibility or responsible business practices;
- Sectoral laws and regulations (agriculture, defence and security, mining and minerals, real estate and construction; services like telecommunications, transportation, utilities, media, finance, entertainment and tourism, health care, professional and retail; manufacturing sectors);
- Laws addressing specific issues, e.g. franchising, SMEs, special economic zones (SEZs), licensing, technology transfer, privatization, public-private partnerships, M&As, insurance, etc.;
- Dispute settlement and law enforcement;
- National vs. local laws and regulations.

Additional areas of law that affect FDI can be thought of. Sometimes these areas are covered by a general foreign investment law, though an elaboration in separate laws is usually called for. In the more developed countries, a general FDI-related law is usually absent. The legal framework for FDI in its broadest sense is therefore extensive though most would apply to all enterprises and are not specific to FDI. It is obvious that the national legal framework for FDI – consisting of laws in all those areas including more detailed implementing rules and regulations as contained in numerous decrees and other legal instruments – can become very complex. The extent of coverage and degree of actual implementation and due enforcement denote the overall quality of the **"rule of law"** which is an important aspect of assessing the overall investment climate in any given host country. A few guiding principles are presented here for an effective national legal framework in general (not limited to FDI):

First, it should be **fair**, i.e. it should ideally not discriminate between national and foreign investors and both nationals and foreigners should have equality before the law (see box 4.4). Second, it should be **transparent and accessible**. Relevant laws and regulations should be well formulated in clear language and duly published, including in English. Third, the legal framework should be **predictable**, i.e. not change too often which creates uncertainty. Fourth, it should be formed with consent of all stakeholders and through an inclusive process to have legitimacy. Fifth, it should **conform to** recognized international principles and obligations. Sixth, it should **protect human rights**. Seventh, it should **ensure** public safety and order. Eighth, is should be **duly implemented and enforced** by a non-corrupt policy force and independent court system (separation of powers and fair and timely trial). For government regulations to serve their ultimate purposes, they have to be designed and implemented in an objective, consistent, transparent, and non-arbitrary manner so that they are not used as a rent-seeking mechanism for industry incumbents, politicians, or bureaucrats (Sun, 2002). Because many legal frameworks are lacking in one or more of these guiding principles, foreign investors favour some form of international legal framework, e.g. a bilateral investment treaty (BIT) that spells out the rights of investors clearly, cannot be modified unilaterally or as easily as domestic law, and offers them recourse to international arbitration and dispute settlements (see below).

The challenge in forming an effective legal framework in any area is to strike a balance between **stability** and **efficiency**. Smart, efficient and balanced regulation is required to ensure stability. The reduction or elimination of burdensome, counterproductive and ill-conceived regulations is required to ensure efficiency. An effective market economy operates on the principle of market rules and hence places a premium on the absence of laws and regulations that interfere with market decisions. However, markets do fail and government intervention is required to not only ensure public safety and order but, with specific reference to sustainable FDI, to ensure sustainability as well. This aspect has assumed increased importance in recent years in both national and international legal frameworks. Properly formulated, laws and regulations can ensure that FDI is sustainable and may obviate the need to go through a cumbersome and often inefficient case-by-case screening process.

In many developing countries, the legal framework is often too obsolete to be an effective instrument in attracting and benefiting from FDI. In fact, a number of redundant laws and regulations continue to impede FDI. Red tape, poor implementation and enforcement create further barriers to FDI. Investors often cite the arbitrary enforcement of actual or imaginary rules (invented by local government officials) and frequent inspections to check compliance as important barriers to the effective operation of a business. Tax and Customs regulations are also often cited as obstacles (Sun, 2002). The presence of a clear, transparent and stable legal framework is often accompanied by the existence of an effective institutional framework as well. The two are basically inseparable as no institutional framework can be developed without the foundations of a clear legal framework.

Box 4.4. The Investment Law of Cambodia

Cambodia's Law on Investment was implemented in 1994 and amended in 2003, which has allowed for some level of stability of the legal regime for FDI. The Law does not discriminate between foreign and domestic investors both pre- and post-establishment, except with regard to land ownership. The Law on Investment and the Amended Law on Investment state that the majority interest in land must be held by one or more Cambodian citizens. The Law generally established an open and liberal foreign investment regime. All sectors of the economy are open to foreign investment and the Government permits 100% foreign ownership of companies in most sectors. In a few sectors, such as cigarette manufacturing, movie production, rice milling, gemstone mining and processing, publishing and printing, radio and television, wood and stone carving production, and silk weaving, foreign investment is subject to local equity participation or prior authorization from authorities.

The Law created an investment licensing scheme to regulate the approval process for FDI and provide incentives to potential investors. In March 2003, the Government simplified the licensing scheme and increased transparency and predictability by enacting the Law on the Amendment to the Law on Investment (Amended Law on Investment). The licensing scheme for investments of less than $2 million was clarified in a sub-decree on the Establishment of the Sub-Committee on Investment in the Provinces-Municipalities of the Kingdom of Cambodia in February 2005. Sub-decree No. 111 on the Implementation of the Law on the Amendment to the Law on Investment, issued in September 2005, lays out detailed procedures for registering a Qualified Investment Project (QIP) with the Council for the Development of Cambodia (CDC) and provincial/municipal investment sub-committees. FDI must be registered at the Ministry of Commerce, and investors must obtain operating permits from the relevant line ministries. If a foreign investor seeks investment incentives as a QIP, he/she must register and receive approval from the CDC or the Provincial-Municipal Investment Sub-Committee.

The Law describes the functions of the CDC as the sole and One-Stop Service organization responsible for the rehabilitation, development and the oversight of investment activities. The Law outlines in detail investment procedures, guarantees and available incentives. Among the guarantees are no nationalization, free repatriation of profits and no restrictions on foreign exchange, no price controls and no requirements for local equity participation. The Law also covers land ownership, use and employment practices. It stipulates that investors in the country shall be free to hire Cambodian nationals and foreign nationals of their choosing in compliance with the labour and immigration laws. It also covers dispute settlement and states that except for land-related disputes, any dispute relating to a QIP concerning its right and obligations set forth in the law shall be settled amicably as far as possible through consultation between the CDC, the investors and any other party involved in the dispute. The Law provides for the opportunity for external arbitration. The Law does not cover sustainability issues.

However, the Law also has its flaws, in particular in the area of approvals and incentives which are granted on a rather discretionary basis. Poor enforcement of the Law means that discrimination among investors still takes place. The protection provisions are rather outdated and not in line with ACIA. The Law should therefore not be considered a best practice. However, it is noteworthy that Cambodia as an LDC understood the need for non-discrimination at an early stage. Most recently in 2016, Myanmar, another LDC, followed suit with an investment law replacing the earlier Foreign Investment Law of 2012. In Thailand, a Foreign Business Act of 1999 still prevails.

Cambodia is also in the process of finalizing a competition law. All relevant laws and regulations related to FDI can be accessed at: http://www.cambodiainvestment.gov.kh/laws-regulation.html.

Sources: United States Department of State. Available from **http://www.state.gov/documents/organization/228917.pdf**; **http://www.jica.go.jp/cambodia/english/office/topics/pdf/14_Appendix-2.pdf**.

Many developing countries in the initial stages of development or reform adopt a generic foreign investment code or law and tend to think that the adoption of such a law is sufficient to attract FDI. Often the adoption of such a law is only the beginning of an effective legal framework for FDI (Sun, 2002). In the absence of required laws and regulations in all other areas outlined above, a foreign investment law alone is not sufficient and often not even necessary. A foreign investment law is a law regulating investments made by foreigners or non-nationals in a specific country. It usually addresses issues related to national security, sovereignty and development but is also an important legal instrument granting protection and guarantees for investors and their investments. It contains a definition of investment, e.g. assets, technology, knowledge, and any other form of capital that is brought into a country for business purposes. The law also covers admission/entry and specifies when, how, in what sectors and to what extent foreigners may invest in a country. It normally regulates ownership and protection, repatriation of profits, rights and obligations of investors vs. rights of the state, land and labour use, restrictions, often contains performance requirements and incentives, provisions for dissolution and liquidation, investment approval and promotion, registration, arbitration and establishment, roles and functions of an IPA.

The following handbook prepared by the Investment Climate Advisory Services of the World Bank Group (Daniel and Forneris, 2010) provides details on all aspects of formulating a foreign investment code or law: "Investment law reform: A handbook for investment practitioners." This book can be accessed at: **http://documents.worldbank.org/curated/en/306631474483143823/pdf/911740WP0Box3800Law0Reform0Handbook.pdf**.

The adoption of a foreign investment law, or an investment law that covers both foreign and domestic investment, can be a useful first step towards the development of a comprehensive legal framework for FDI, in particular under a complex reform process such as the establishment of a market economy. While it is not essential for a country to have a foreign investment law, there are some advantages (Daniel and Forneris, 2010):

- It is an important instrument of policy implementation in terms of the role of the private sector and FDI in development;
- It clarifies the rights and obligations of foreign investors and the host government and its institutions;
- It is a useful tool for investment promotion as it provides investors with an easy overview of the investment climate in a country;
- It provides security to private investments and spells out all provisions related to investor protection, including available dispute settlement mechanisms;
- It enhances transparency of the regulatory framework for investment and therefore contributes to good governance.

In addition, there are advantages to combine foreign and domestic investment in one investment law. In particular, it would send a clear message that host countries do not discriminate between domestic and foreign investors (see box 4.4 above) though often reverse discrimination in favour of foreign investors takes place (already the case in view of provisions existing in BITs a host country may have with the home country of the investor that per definition only applies to the foreign investor) (Subedi, 2012). In addition, it would be easier to amend and implement a consolidated investment law.

Whether a country chooses to adopt a foreign investment law, it is important that it is consistent with other laws and regulations of the country. UNCTAD (2016a) provides a recent update of the extent and coverage of investment laws around the world. Among the main findings were the following:

- At least 108 countries have an investment law as a core instrument to govern investment.
- Investment laws are particularly common in the Asia-Pacific region.
- Investment laws are part of the overall policy framework of host countries and not the only instrument to deal with investment.
- Even though investment laws generally share the same objectives, their content and overall approaches differ strongly.
- Most investment laws have investment promotion as their main objective, while only a few also deal with investment facilitation.
- Sustainable development is an explicit goal only in a small minority of them.
- Investment laws tend to show an imbalance between the coverage of investor rights and obligations.
- Investment laws often cover the same issues as investment treaties and more than half of the laws provide access to international arbitration.
- The importance of investment laws calls for a deeper analysis of their content and their consistency with international investment policies.
- There is a need to strengthen the coherence between investment laws and other public policies, such as trade, tax, competition, social and environmental policies.

Traditionally, a (foreign) investment law covers the **entry provisions** for FDI (including specification of prohibited sectors and other restrictions (preferably as a negative list), performance requirements, screening and registration processes) and the following guarantees for foreign investors (Sun, 2002; Daniel and Forneris, 2010):

- **Non-discrimination**: national or equal treatment of foreign and domestic investors and most-favoured nation (MFN) treatment (in particular in the post-establishment phase and increasingly common in the pre-establishment phase of investment).

- **Right to ownership and security of investment**: guarantees against arbitrary nationalization, unlawful expropriation, or confiscation of their property, or any other governmental measure with similar effect; prompt, adequate, and effective compensation in the event of expropriation.
- **Convertibility and repatriation of capital and earnings.**
- **Fair and equitable treatment** (with clear definitions and scope of application).[72]
- **Access to international dispute resolution mechanisms**: Many private investors operate in countries with weak rule of law. Established international dispute settlement mechanisms exist which should be available to foreign investors in any country.[73]
- **Expatriate labour**: though host countries routinely insist on the use of local labour, in many cases the use of foreign experts, managers and technical personnel cannot be avoided.

In line with the trend to rebalancing international investment agreements (see section C below), national investment laws should also be formulated in a way that balances investor rights with host country legitimate development concerns. However, if such a law does not contain minimum protection provisions for investors it loses relevance. Various FDI codes or laws also specify investment promotion tools such as the establishment and responsibilities of an IPA and available incentives. The World Bank advises that investment promotion and incentives are covered in separate pieces of legislation, however (Daniel and Forneris, 2010). In particular, incentives should be defined and organized in tax/customs codes/laws rather than investment codes/laws (see chapter 5).

The foreign investment law should evolve over time and be made redundant with the development of specific laws in all relevant areas and sectors. While there are a number of particular areas that are important determinants for various types of investment, legal provisions regarding ownership of and access to land and property rights in general stand out as particularly important (box 4.5).

Box 4.5. Legal provisions for FDI: land ownership and access

The ownership of land by foreigners is traditionally a sensitive issue in developing countries. There are fears that foreigners would engage in neo-colonial behaviour and exploit the land, including land speculation that would drive up prices, with little benefit for the host country; that FDI would negatively affect local communities living on the land or that foreign ownership would interfere with hard won national sovereignty and lead to loss of control of a host country over its own territory. Foreign ownership of land, in particular public land, is particularly sensitive in the agriculture and mining sectors with added fears that countries lose control over their own natural resources or that it may compromise national food security. These fears have been fuelled by large-scale land purchases by foreigners (in particular those from China) in both developing countries (e.g. in Africa) and developed countries (e.g. in Australia). At the same time, it is also recognized that effective access to land is an important determinant for FDI (World Bank, 2010). However, effective access to land and use of the land does not have to involve wholly-owned foreign ownership but can involve long-term leases that provide guarantees to foreign investors on their access to and use of land. Nevertheless, ownership would grant foreign investors added advantages, such as the possibility to use the land to raise capital through a mortgage.

In developed countries, the restrictions on foreign land ownership are usually much less restrictive than in developing countries. There is no evidence that foreign ownership of immovable assets in the United States or Europe has negatively affected these countries in any way. Fears in the United States in the 1990s of a Japanese take-over of the country proved unwarranted, though similar fears of a Chinese take-over are currently spreading in various developed and developing countries. In contrast, such foreign ownership has contributed to national taxes and other benefits resulting from foreign investment. The absence of reciprocity is striking. For instance, while the average Asian

72 The issue of FET has increasingly become controversial as it is a typical clause that investors have exploited at the cost of the host country. It is important that investment laws provide a proper balance between investor rights and obligations and if FET is included, it should be carefully defined and limited in scope.

73 Similar to FET, the access to international arbitration, while common in IIAs, is somewhat controversial as a clause in domestic investment laws and there is an increasing tendency to leave such clauses out altogether. However, in the absence of a strong domestic rule of law, such clauses may be essential to attract large-scale and strategic FDI projects for instance in the mining sector, unless there is a clear investment contract or BIT with the investors home country that contains ISDS provisions.

can freely purchase property and land in most Western countries, citizens from these countries do not have the same rights in Asia. Indeed, in most Asia-Pacific countries, foreign land ownership remains either prohibited or severely restricted. The difference between developed and developing countries is that the rule of law in the former is usually much better and, hence, the potentially negative implications of foreign land ownership are prevented through the adoption and due enforcement of proper laws and regulations that do generally not discriminate between foreigners and nationals. Only in selected cases of large-scale investments involving national or food security interest considerations have governments of selected Western countries intervened. In many developing countries, foreign investors often encounter weak land use rights which can impede their ability to operate and plan for the long term. Limits on land use rights can include short lease terms, obstacles to renewing and transferring land rights, and restrictions on the ability to mortgage land or use it as collateral. Burdensome land acquisition procedures and lack of information on suitable sites are additional obstacles that affect investors' decisions (World Bank, 2010).

There have been positive developments overall. Prompted by the Asian 1997 financial crisis, various countries in Asia have further liberalized FDI, including ownership of property and land. Long-term leases are often guaranteed, in particular in SEZs. In the context of mining operations, investment contracts have specific provisions on the access to and use of land by foreign investors. While some countries ban the ownership of land, they are more flexible with regard to the use by foreigners of land. In some countries, foreigners can own all or part of the buildings on a certain plot of land but not the land itself (e.g. Thailand). In others, private land ownership, whether by nationals or foreigners, is prohibited for ideological reasons though private use of land is rather liberal (e.g. China, Viet Nam). Others limit the size of land foreigners can own or lease or ban the purchase of land by foreign individuals but allow for foreign companies (obviously for economic reasons). In many countries, foreigners can own or use land through a proxy or joint venture with a local company (e.g. Thailand). Often, this creates loopholes in the law that can be exploited.

The sources for restrictions on foreign land ownerships are very broad and include legislation (usually provisions in a general foreign investment law or the land law and codes), judicial decisions, case-by-case application reviews, the country's constitution, the civil code, administrative regulations, etc. The nature and form of the restrictions depend on the policy objective. This objective will also determine the exact definition of "foreigner." Hodgson and others (1999) distinguishes the following two broad regulatory approaches to land ownership:

- The outright ban, usually involving ownership but rarely lease.
- Foreign land ownership and/or use is permitted, but subject to regulation and various restrictions related to location, sector, and size of land. Some countries require prior authorization or some form of registration/notification. There are many variations.

Hodson and others (1999) concludes that "given the disparate range of practices and techniques undertaken by states in relation to foreign land ownership, perhaps the only conclusion one may draw is that there is no direct correlation between the nature and extent of restrictions on foreign ownership of land and a country's economic strength; stage of development; political system and constitutional arrangements; size; or history of colonization or foreign domination."

From the above analysis, some common policy recommendations can be summarized:

- Land acquisition and use rights should be clear, transparent and secure.
- They should balance the needs of investors and legitimate concerns and rights of the host country and local communities.
- Rules should remove unnecessary and burdensome steps while enabling authorities to conduct a proper process with fair protections for the greater public good.
- Land administration institutions should provide businesses with a single point of access.
- Due information on the prevailing laws and regulations should be made available to investors in English.
- Both national and foreign ownership and use of land and other assets should be subject to social and environmental conditions as specific by the law.
- Laws should provide sufficient security to investors so that they feel comfortable operating and expanding their businesses, and should not limit their ability to develop, renew, transfer, mortgage, or sublease land. Foreign investors will generally find a secure and transparent long-term lease almost as good a full ownership.
- Land records should be up-to-date, centralized, integrated (linked across relevant government agencies), easily accessible (preferably with online access), and provide information useful to investors and the general public.

It is increasingly recognized that FDI can result in foreign land purchases or tenures that undermine national food security and national ownership of and access to natural resources. It is important that foreign land ownership and tenure is balanced with host countries' legitimate sustainable development concerns, including food security. In this

context, countries adopted the Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security which were endorsed by the Committee on World Food Security on the 11th May 2012. The Guidelines promote secure tenure rights and equitable access to land, fisheries and forests as a means of eradicating hunger and poverty, supporting sustainable development and enhancing the environment. The Guidelines can be accessed at: **http://www.fao.org/docrep/016/i2801e/i2801e.pdf**.

Source: FAO; Hodgson and others (1999); World Bank (2010).

As countries develop, the adoption of laws in particular areas previously not considered essential becomes more important to ensure the sustainability of the development process. A clear example is laws governing intellectual property rights. While IPR protection is generally not considered an essential component in FDI attraction for an LDC, over time its importance will grow as the country intends to move out of labour-intensive (and, hence, low levels of knowledge-intensive) forms of FDI towards the attraction of more value-added and capital/knowledge-intensive forms of FDI in accordance with rising wage and skills levels and productivity. Box 4.6 explores the role of IPR in FDI attraction and technology transfer in more detail.

Box 4.6. The role of IPR protection in FDI attraction and technology transfer: Does it matter?

Since the adoption of the WTO TRIPS Agreement, attention to IPR and their protection have significantly increased, in particular with regard to their role in attracting FDI. In fact, both RTAs and bilateral investment treaties increasingly cover IPR and if they do not have explicit chapter or provisions on IPR, they still cover intellectual property under the definition of "investment", basically applying all clauses on investment also to intellectual property though the UNCTAD Investment Policy Framework for Sustainable Development covering IIAs recommends to omit IPR not protected under domestic law from the definition of "investment". Obviously, the protection of IPR is of particular importance to the holders of IPR, i.e. usually TNCs from developed countries. These TNCs would normally not target LDCs or other developing countries which focus on the attracting of resource or market seeking or labour-intensive efficiency-seeking FDI which does not involve high technology. As a result, TNCs active in these sectors would normally not look at the level of IPR protection as an important determinant.

However, when the country develops and seeks to attract more sophisticated FDI with the explicit purpose to transfer technology and boost national innovation, the role of IPR becomes more important. Various studies show a positive link between the level of IPR protection and FDI. Nunnenkamp and Spatz (2004) find that stronger IPR protection not only increases the quantity but also the quality of FDI. Awokuse and Yin (2010) show the importance of a strengthened IPR regime in China on FDI inflows and conclude that their results suggest that the strengthening of IPR in developing countries, particularly large economies, might play a positive role in attracting FDI and thus promote technology transfer. Zekos (2013) points to the importance of competition and effective competition policy as complementary to IPR as a strong determinant of FDI inflows (and also outflows). The role of IPR in attracting FDI without complementary competition would be weaker.

IPR would obviously be expected to play an important role in countries specifically targeting FDI in R&D. As Guimón (2008) shows through the literature review in his paper, the attraction of FDI in R&D depends on various factors, not just IPR but in particular the availability in the host country of world class research infrastructure and skilled labour at affordable wage levels and well-developed national innovation systems. Other location drivers suggested in the existing literature are the presence of other TNCs active in R&D; public incentives to corporate R&D; the climate and quality of life; the English language skills of the local population; and the bureaucracy, paper work and time associated with creating an R&D enterprise, apart from IPR protection.

In poorer countries, a too strict level of IPR protection may actually undermine domestic investment and R&D which is often dependent on access to existing technologies, without being a main attraction for FDI. Nicholson (2007), reports that when IPR is strong, firms with high investment in R&D are more likely to enter a market by licensing to an unaffiliated host firm rather than through investment. However, generally, the evidence shows that a strong IPR regime does play an important role in attracting FDI but that IPR protection alone is not sufficient. An open economy and stable economic and political climate is also important along with other determinants of FDI (Adams, 2010).

Source: references quoted in text.

Generally, countries that have a superior legal framework for FDI are those that:

- allow FDI across (and in virtually all) sectors;
- provide equal treatment of foreign and domestic investors;
- have a simple and transparent establishment process;
- provide easy and secure access to and use of land (through ownership or long-term leases) and maintain efficient land acquisition procedures;
- enforce strong arbitration laws and/or allow access to domestic and international arbitration and recognize and enforce foreign arbitration awards;
- ensure conformity to international principles and laws;
- have a supportive, independent, efficient and impartial court system and fair trials;
- have superior quality of legal services;
- enforce non-restrictive labour laws;
- offer adequate[74] IPR protection;
- allow for easy repatriation of profits.

The World Bank had designed an indicator on investing across borders that allows for a comparison among countries' strength of the rule of law with regard to FDI (box 4.7).

Box 4.7. The World Bank's Investing Across Borders indicator

The World Bank has issued a set of four indicators measuring the ease of FDI in 87 countries. In 2011 and 2012 it expanded the number of countries to 104 and added one more indicator. The indicators are as follows:

- **Investing across sectors**: This topic measures statutory restrictions on foreign ownership of equity in new investment projects.
- **Starting a foreign investment**: This topic quantifies the procedural burden that foreign companies face when establishing a foreign-owned subsidiary, several aspects of land administration regimes important to foreign companies seeking to acquire industrial land, as well as the existence and characteristics of special economic zones.
- **Arbitrating and mediating disputes**: This topic analyses aspects of domestic and international arbitration regimes in each country: the strength of the legal framework for alternative dispute resolution, rules for the arbitration process, and the extent to which the judiciary supports and facilitates arbitration.
- **Converting and transferring currency**: This topic measures foreign exchange restrictions most relevant for foreign direct investment across economies to identify common policies and benchmark the restrictiveness of economies' foreign exchange regimes.
- **Employing skilled expatriates**: This topic measures the rules for and the process of obtaining sponsored temporary work permits for foreign executives and specialist staff.

The indicators can be accessed by country at: **http://iab.worldbank.org/Data/ FDI-2012-Data.**

Source: World Bank.

As countries develop, obviously the legal framework will develop with it. With particular reference to the 2030 Agenda for Sustainable Development countries are expected to strengthen the legal framework to achieve the sustainable development goals. The involved legislation should be transparent and formulated on the basis of an inclusive process to ensure all stakeholders are on board, including foreign investors. Foreign investors, on their part, also will have to understand that their presence in a host country requires a balancing of their rights with the legitimate development concerns of the host country. They are expected to contribute to the SDGs and accept social and environmental responsibility in undertaking investment both in their home and host countries. However, often foreign investors have legally challenged changes in the legal framework based on clauses contained in international investment agreements and have often won at the detriment of the host country. This

[74] What constitutes "adequate" is not clear. Various IIAs refer to the protection of IPR at the "highest international standard" but as no single standard exists, this is subject to interpretation.

has put FDI in a bad light. Foreign investors have a duty to conform to best practices in responsible business conduct. However, the international legal framework is also changing to allow for a proper balance between investors' rights and host countries' legitimate development rights (see below).

C. THE INTERNATIONAL LEGAL FRAMEWORK FOR FOREIGN DIRECT INVESTMENT

1. The evolving international investment agreements universe

(a) Overview

The national legal framework has been increasingly modified by commitments made by governments at the international level. The international legal framework for FDI has become increasingly complex and consists of international investment agreements (IIAs) between and among governments, investment contracts between host governments and foreign investors and relevant agreements within the context of the multilateral trading system (and administered by the World Trade Organization (WTO)).

IIAs comprise bilateral investment treaties (BITs) and treaties with investment provisions (TIPs) which are typically free trade agreements (and any variation thereof such as preferential trade agreements, regional trade agreements, economic partnership agreements, customs unions, etc.) that contain investment provisions/ chapters or provisions in areas that have implications for FDI (e.g. IPR, services).[75] Avoidance of double taxation treaties (DTTs) is also FDI-related but is not IIAs. While the primary purpose of BITs is to protect foreign investments, DTTs address issues arising out of the allocation of the revenues generated by these investments between host and home countries – for instance, how to allocate tax revenue from taxes imposed on income earned by multiple entities of a TNC system. As IIAs (and DTTs) are agreements between two or more governments they are governed by international law (the Law on Treaties for instance). UNCTAD's International Investment Agreement Navigator provides a detailed overview and analysis of all known BITs and TIPs. The Navigator contains a detailed database mapping the content of IIAs, which is a collaborative initiative between UNCTAD and universities worldwide. The Navigator and database can be accessed through UNCTAD's Investment Policy Hub at **http://investmentpolicyhub.unctad.org/IIA.**

At the multilateral level, no investment agreement exists though attempts were made some time ago to conclude a multilateral agreement on investment (MAI). However, these efforts came to nothing as developing countries feared that the agenda was too much driven by Western countries and dominated by the rights of foreign investors rather than the development needs of host countries though recently interest in a MAI has been growing again given the proliferation of IIAs (box 4.8).

However, investment is indirectly governed at the multilateral level by a number of WTO agreements, in particular the Agreement on Trade-Related Investment Measures (TRIMS) which prohibits a number of trade-related measures governments could impose on foreign investors as performance requirements (in particular local content and trade balancing requirements), the General Agreement on Trade in Services (GATS) which recognizes commercial presence (i.e. FDI) as one of four modes of services trade, and the Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) which sets minimum standards for IPR. Many TNCs are the owners of intellectual property and intellectual property is normally recognized as a form of investment as defined in outstanding international trade agreements and investment treaties (Chaisse and Nagaraj, 2014). Attempts to include trade and investment as a formal negotiation area (part of the so-called "Singapore issues"[76]) failed due to similar concerns surrounding the MAI. In addition to these WTO agreement, the Energy Charter Treaty extends WTO trade rules to energy products and equipment (but not services) and accords investment protection at levels normally found in higher end BITs (box 4.9). Another sign of international

[75] For a detailed definition and coverage of TIPs, see UNCTAD (2016c), Box III.3.

[76] The "Singapore issue" refer to three working groups set up during the WTO Ministerial Conference of 1996 in Singapore. These groups were tasked to deliberate on the following issues: transparency in government procurement, trade and investment, and trade and competition. Ministers also instructed the WTO Goods Council to look at possible ways of simplifying trade procedures, or trade facilitation. These four subjects were originally included on the Doha Development Agenda. The carefully-negotiated mandate was for negotiations to start after the 2003 Cancún Ministerial Conference, "on the basis of a decision to be taken, by explicit consensus, at that session on modalities of negotiations". There was no consensus, and the members agreed on the 1st August 2004 to proceed with negotiations in only one subject, trade facilitation. The other three were dropped from the Doha agenda. Available from **https://www.wto.org/english/thewto_e/whatis_e/tif_e/bey3_e.htm**.

convergence is the *Shared Principles for International Investment*, adopted in 2012 by the EU and the United States, whose purpose was to smooth the way for a Transatlantic Trade and Investment Partnership Agreement.[77] The G20 Guiding Principles for Global Investment Policymaking discussed in chapter 3 could also be interpreted as a prelude towards deeper and wider global investment rules (Joubin-Bret and Chiffelle, 2016).

Box 4.8. Towards a new multilateral investment agreement?

Negotiations on a proposed multilateral agreement on investment (MAI) were launched by governments at the Annual Meeting of the OECD Council at Ministerial level in May 1995. The objective was to provide a broad multilateral framework for international investment with high standards for the liberalization of investment regimes and investment protection and with effective dispute settlement procedures, open to non-OECD countries. Negotiations were discontinued in April 1998 and, according to OECD, will not be resumed.[78]

The MAI sought to establish a new body of universal investment laws that would guarantee corporations unconditional rights to buy, sell and do financial operations all over the world, without any regard for national laws and citizens' rights. The draft gave corporations a right to sue governments if national health, labour or environment legislation threatened their interests. However, the negotiations failed in 1998 when first France, and then other countries, successively withdrew after pressure from a global movement of NGOs, citizens groups and governments of poor countries. MAI opponents saw the agreement as a threat to national sovereignty and democracy and argued that it would lead to a "race to the bottom" in environmental and labour standards.[79]

However, given the expansion of the "spaghetti bowl" of IIAs, though at reduced rate, along with the expansion of global value chains, some have called for reviving the idea of an MAI or Multilateral Framework for Investment (MFI) that would better balance the rights of investors and host countries, in particular developing countries (Hufbauer and Stephenson, 2014; Sauvant, 2016). Business firms around the world need multilateral disciplines and market access guarantees. In the FDI realm, these have not yet been provided by the WTO, though the WTO may arguable be the best platform to negotiate and monitor the implementation of such an agreement (Sauvant, 2016).

The current patchwork of investment disciplines in FTAs and BITs leaves many countries out. At the same time, many developing emerging countries have become outward investors and may have an interest in multilateral disciplines. An investment framework agreement with modern disciplines is therefore both necessary and overdue. However, it has also been observed that to the extent that one aims at further investment liberalization, it can be achieved more easily among a limited number of countries at the bilateral, regional or plurilateral level. More generally, the prospects for a multilateral investment treaty decrease when more countries aim for an ambitious treaty dealing with all policy facets of FDI. Thus, the value added by a new multilateral undertaking would not lie primarily in its substantive content, but in other aspects, such as strengthening the bargaining position of developing countries, efficiency gains through multilateral treaty coverage, the achievement of greater policy coherence, and the possible avoidance of investment distortions (Karl, 2014). It is important that a new MFI does not add a new layer of legal obligations but replaces the existing universe of bilateral and regional investment agreements. While this is certainly desirable, this is not likely to happen any time soon. It should also be noted that it is perhaps better to have no multilateral agreement at all than a weak one based on the lowest common denominator.

Currently, there are attempts by a select group of countries, including some developing countries (i.e. Argentina, Australia, Brazil, Chile, China, Colombia, European Union, Indonesia, Japan, Republic of Korea, Mexico, Pakistan, Russian Federation and Turkey), to include investment facilitation in the WTO negotiations, but others (e.g. India, South Africa, United States) have opposed proposals in this area citing a lack of mandate for the WTO. Earlier attempts to integrate trade and investment in the official multilateral trade negotiations under the Doha Development Agenda also failed.[80]

Source: OECD, references quoted in text. See also UNCTAD (2015b).

[77] Available from **http://trade.ec.europa.eu/doclib/docs/2012/april/tradoc_149331.pdf**.

[78] Available from **http://www.oecd.org/investment/internationalinvestmentagreements/multilateralagreementoninvestment.htm**.

[79] Available from **https://www.globalpolicy.org/globalization/globalization-of-the-economy-2-1/multilateral-agreement-on-investment-2-5.html**.

[80] Trade and investment was one of the so-called "Singapore" issues decided to be included in the mandate of the Doha Development Agenda of multilateral trade negotiations under the WTO. However, this issue was dropped at the Fifth WTO Ministerial Conference held in Cancún, Mexico from the 10th to 14th September 2003. Only trade facilitation was kept as a negotiation issue.

Investment contracts are agreements between an individual host government and a foreign investor in a particular sector for a particular investment, usually in the mining and extractives sectors. They determine the distribution of risks, costs and benefits of the project. They aim to balance the legal rights and obligations of the investor and the state and are prevalent in mining. They spell out benefit/production and revenue sharing/royalties arrangements, etc. from mining projects. These contracts typically call for international dispute settlement mechanisms between governments and a foreign investor, similar to ISDS provisions in intergovernmental IIAs. As a result, they can bypass local courts.

Box 4.9. The Energy Charter Treaty

The Energy Charter Treaty (ECT) is an international agreement which establishes a multilateral framework for cross-border cooperation in the energy industry. The treaty covers all aspects of commercial energy activities including trade, transit, investments and energy efficiency. The treaty is legally binding, and includes dispute resolution procedures. The ECT and the Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects were signed in December 1994 and entered into force in April 1998. As of today, the ECT has been signed by 51 states and the European Union. The European Union and 45 states have ratified the treaty. It is noteworthy that the Russian Federation signed but not ratified the treaty. The Russian Federation, however, at first accepted provisional application of the treaty. However, in 2009 the Russian Federation terminated the provisional application, stating its intent not to become an ECT Contracting Party though it remains a signatory to the ECT and participates in the Charter Process.

The provisions of the ECT regarding foreign investments are considered to be the cornerstone of the treaty. The aim of the foreign investment regime is to create a ‘level playing field’ for investments in the energy sector and to minimize the non-commercial risks associated with such investments. The ECT provides for “best endeavour” obligations with regard to the pre-establishment phase of investment but contains binding obligations for Contracting Parties for the post-establishment phase similar to the investment protection provisions of the North American Free Trade Agreement (NAFTA) and BITs.

The investment protection provisions of the ECT are found in Part III of the ECT. Article 10(1) sets out a number of basic principles for the treatment of foreign investments that are frequently found in BITs, such as fair and equitable treatment and “most constant protection and security”. The article also states that the “management, maintenance, use, enjoyment or disposal of investments is not to be impaired by ‘unreasonable or discriminatory measures.’” The last sentence of article 10(1) contains a so-called “umbrella clause” referring to the legal principle of *pacta sunt servanda* (acting in good faith) by making it an obligation of each Contracting Party to “observe any obligations it has entered into with an Investor or an Investment of an Investor of any other contracting party”. Article 13 deals with expropriation. Article 26 of the ECT governs investment disputes between private investors and contracting states, and extends to investors a right to arbitration of such disputes in a national or international court of their choice. In 2015, the ECT was the most frequently invoked treaty for ISDS, followed by NAFTA (UNCTAD, 2016b).

For a detailed analysis of the treaty, see Hobér (2010): **http://intl-jids.oxfordjournals.org/content/1/1/153.full.**

Source: Hobér (2010).

IIAs are signed by host country governments as part of their efforts to attract FDI. Though the relevance of IIAs as an important determinant for FDI is ambiguous, most studies find a positive if relatively small correlation between IIAs (the host country is party of) and FDI inflows to the host country (from the other, usually more developed, IIA partner countries). In the mining sector, particularly investment contracts are important. Various studies contained in Sauvant and Sachs (2009) found that concluding BITs does have a positive effect on FDI inflows and that the effect is larger when developing countries conclude these agreements with economically more important countries. Neumayer and Spess (2005) also found that a higher number of BITs was associated with higher FDI inflows to a developing country. Bhasin and Manocha (2016) also find a positive correlation between BITs and FDI inflows to India. Berger and others, (2010) find that FDI reacts positively to RTAs only if they offer liberal admission rules. Dispute settlement provisions seem to play a minor role. Sirr and others (2017) find that BITs are more positively related to vertical rather than to horizontal FDI, in other words they tend to matter more for efficiency-seeking FDI engaged in GVCs. Another study found that BITs have a strong positive impact on FDI inflows for the pre- Asian financial crisis (1997) era. However, the strength of this positive impact diminishes as more BITs are concluded, implying that each additional BIT yields a relatively smaller FDI-payoff (Min and others, 2011).

There is evidence that investment provisions or chapters in wider regional trade or economic partnership agreements have a larger impact on investment flows than BITs (Lesher and Miroudot, 2007). Generally, while IIAs can be a factor in FDI attraction, in particular in the case of deeper and broader economic partnership agreements with substantive investment chapters, IIAs alone are never sufficient (UNCTAD, 2009, 2014). However, they probably play a more important role when they involve both developed and developing countries. For instance, one study found that IIAs concluded between ASEAN countries and developed countries had a positive impact on FDI inflows while the AIA (now replaced by ACIA) had negligible impacts on intra-ASEAN FDI (Booppanon, 2007). Often IIAs provide the legal backing for governments to implement domestic reforms and enhance the transparency and predictability of the legal framework for investors (Chaisse and Bellak, 2015). Home countries of investors sign these agreements to offer protection of their investors, for instance against expropriation or nationalization or unfair and discriminatory treatment. The most common form of IIA is the BIT.

(b) Structure and provisions

BITs usually contain the following provisions, with some more common than others, and which mirror many provisions found in domestic investment laws:

- Preamble;
- Positive vs. negative list;
- Definitions/scope/coverage: investment normally defined widely;
- Mostly protection, some promotion and sometimes liberalization and/or facilitation;
- Entry and treatment: Most-favoured nation (MFN)/national treatment (NT); pre-establishment (rare) vs. post-establishment, covering investor and/or investment;
- Exceptions;
- Prohibition of performance requirement (increasing lists);
- Expropriation/compensation;
- Fair and equitable treatment (FET);
- Full protection and security (protection from strive);
- Transparency;
- Balance of payments protection;
- Subrogation;
- Denial of benefits;
- Repatriation of funds/transfers;
- Environmental/labour clauses;
- Joint investment committee;
- Subnational government;
- Dispute settlement: state-state; state-investor (ICSID, UNCITRAL, etc.)-trend towards more precise language.

While a detailed discussion of the various provisions goes outside the scope of the present document, three areas require a special mention: definition of investment; provisions that contain the **"main standards of protection"** and those that cover **dispute settlement**.[81]

Most IIAs define investment broadly to comprise (a) movable and immovable property and other property rights such as mortgage, liens or pledges; (b) shares, stocks, debentures and similar forms of participation; (c) bonds, loans and other forms of debt instruments; (d) rights to money or to any performance under contract having a financial value; (e) intellectual property rights, goodwill, technical processes and know-how as conferred by law; (f) business concessions conferred by law or under contract, including concessions to search for, extract or exploit oil and other minerals and other natural resources. Such a wide definition puts limitations on governments to pursue legitimate development objectives. For instance, the issuance of a compulsory license for a generic medicine may be compliant with the WTO TRIPS Agreement but may be perceived by a foreign investor in pharmaceuticals as an (indirect) expropriation (see e.g. Gibson, 2009; Mercurio, 2011).

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81 IIAs and related key issues are comprehensively discussed in UNCTAD (2004), the UNCTAD Investment Policy Framework for Sustainable Development and the most recent UNCTAD World Investment Reports (Chapter III).

Main standards of treatment cover expropriation and nationalization (both direct and indirect) and full compensation, “minimum standards of treatment”, and transfer of funds (free transfer of funds in and out of the host country subject to applicable exceptions). Minimum standards of treatment comprise non-discrimination (**most-favoured nation** clauses which call for equal treatment of foreign investors from all countries, and **national treatment** clauses which call for equal treatment of foreign and national investors), provisions under “**fair and equitable treatment**” (FET) which address the potential for failure of host governments to address legitimate expectations on the part of the investor, and provisions that cover full protection and security (Chaisse, 2015).

With regard to non-discrimination clauses a distinction is made between **pre-establishment** and **post-establishment** of the investment. Most developing countries are comfortable with post-establishment clauses as they refer to the investment made, but they are less comfortable with pre-establishment clauses that call for non-discrimination of investments not yet made. Such clauses would prevent governments from screening investment applications on their contributions to development. However, developed countries have been vocal on including pre-establishment clauses in IIAs and they have become increasingly common, in particular as development concerns can be adequately addressed through the national legislative framework.

Of greater concern is the increasingly wider interpretation given by investors and their home countries to the concept of fair and equitable treatment which is related to the wide definitions of investment (UNCTAD, 2004). While a wide definition has implications for most other provisions, it also raises all kinds of issues related to what constitutes FET. FET normally refers to issues like interference with rights (of the investor), denial of justice, and regulatory change. This means that whenever a government feels the need to change a law or regulation that affects a foreign investor (or his/her investment), including incentives, the investor may claim that the FET provision has been violated. In a similar fashion, foreign investors have often insisted on **stabilization clauses** in investment contracts that perform a similar role. While foreign investors have a legitimate right to expect a certain measure of stability and predictability in the legal framework, it is also the legitimate right of a government to change the laws and regulations in accordance with the process of development. The different interpretations of what constitutes FET and non-discrimination etc. has given rise to a vast number of investment disputes either between governments (home and host government of the investment) or between the host government and the investor (under investment contracts).

The issue of FET is particularly sensitive with regard to the coverage of IPR, which is routinely emphasized as an important part of IIAs involving developed countries. The United States especially accords great importance to this issue, especially involving IIAs with middle income developing countries. Developing countries, in particular LDCs, see stringent IPR provisions as an impediment to their development and point to the existing provisions in TRIPS as sufficient coverage of the issue and probably already beyond their capacity to implement (LDCs are exempt from TRIPS provisions) while developed countries point out that TRIPS only sets minimum standards for IPR protection. IPR are not usually specifically covered in IIAs but are routinely part of the definition of “investment” and therefore all clauses related to the protection of investment (the main objective of IIAs) would also cover IPR. This means that the host country may be forced to adopt IPR legislation at higher than international standards and in the absence of such legislation may expose the host country to possible legal procedures launched by the investor who may claim compensation. Some IIAs have provisions for protection of IPR at the “highest international standards” but this is subject to different interpretations as there is no single standard. Another issue is that contracts or permits to access or exploit genetic resources may be deemed as an investment and are therefore covered by IIAs. This may lead to potential conflict between the Convention on Biological Diversity and IIAs.

Dispute settlement procedures exist for both state-to-state (SSDS) and investor-to-state (ISDS) disputes. SSDS predates investor–state arbitration, and is governed by customary international law and friendship, commerce and navigation (FCN) treaties and some early investment treaties (Bernasconi-Osterwalder, 2014; Roberts, 2014). SSDS is normally launched for the following reasons: (a) diplomatic protection claims made by home states seeking compensation on behalf of their investors; (b) interpretive disputes about the proper interpretation of investment treaties; and (c) requests for declaratory relief seeking a finding that the treaty has or has not been violated (Roberts, 2014). SSDS is normally conducted by the International Court of Justice or regional courts (Bernasconi-Osterwalder, 2014).

In contrast, ISDS is normally conducted by the International Centre for Settlement of Investment Disputes (ICSID) of the World Bank or the United Nations Commission on International Trade Law (UNCITRAL), while ISDS is normally dealt with by specially appointed international arbitration tribunals (under the International Chamber of Commerce (ICC), UNCITRAL, ICSID, London Court of International Arbitration, Hong Kong International Arbitration Centre, etc.). Dispute settlement clauses in IIAs have become longer and can be very detailed in order to provide clear and unambiguous provisions though in the majority of BITs they remain fairly short (Pohl and others, 2012). This is important as concerns have arisen that dispute settlement usually finds favour on the part of the investor, lacks an appeal process, gives investors various options to pursue their perceived rights while curbing policy space of the host country government, imposes high proceeding costs on the part of developing countries, and undermines the ability of host governments to regulate in the public interest (e.g. IISD, 2014). A recent survey also found that there are many variations among ISDS provisions and that the number of issues regulated in ISDS provisions has remained small (Pohl and others, 2012). Until recently it was universally recognized that foreign investors should have the right to international arbitration. However, there is an increasing trend towards reviewing the ISDS clauses in the wake of numerous ISDS cases settled at the detriment of the host country and some countries are opting to leave ISDS clauses out of their new model BITs altogether (see UNCTAD, 2015b for details).

In July 2014, UNCITRAL adopted the Mauritius Convention on Transparency that is expected to do much to increase the transparency of investor-state arbitrations conducted under thousands of existing investment treaties and under any set of arbitration rules.[82] Within the context of the need to strengthen a global investment regime, there have been calls for the establishment of a permanent or World Investment Court with a proper appeals mechanism, for instance through the negotiation of a treaty updating the present Convention on the Settlement of Investment Disputes between States and Nationals of Other States or ICSID II.[83] UNCITRAL's Mauritius convention approach can also be used to create a permanent multilateral international tribunal for investments or an appeal mechanism (Kaufmann-Kohler and Potestà, 2016). UNCTAD's Investment Dispute Settlement Navigator provides an excellent database on all outstanding international investment disputes (box 4.10).

Box 4.10. UNCTAD's Investment Dispute Settlement Navigator

The UNCTAD Investment Dispute Settlement Navigator contains information about known international arbitration cases initiated by investors against States pursuant to international investment agreements (IIAs). Such arbitrations are also referred to as treaty-based investor-State dispute settlement (ISDS) cases. The ISDS Navigator is:

- **Comprehensive:** the world's most complete ISDS database containing information on 767 publicly known international arbitration cases initiated by investors against States pursuant to international investment agreements (IIAs).
- **User-friendly and inclusive:** the use of the Navigator is free-of-charge, granting access to ISDS information to a large number of stakeholders across countries; the search functions are intuitive and easy to handle, allowing non-experts to access key information.
- **Data-rich:** a source of readily available statistical data on the main aspects of ISDS cases (to view, click on the individual "Filters" below the Map).
- **In-depth and flexible:** the "Advanced search" option allows tailored searches to your needs (e.g. search for all cases against a particular country's group, brought between 2010 and 2016, in which the amount claimed has exceeded $1 billion).
- **Detailed:** each case entry contains information on: legal basis (applicable treaty); countries involved; short summary of the dispute; economic sector and subsector; amounts claimed and awarded; breaches of IIA provisions alleged and found; arbitrators serving on the tribunal; status/outcome of the arbitral proceedings; decisions issued by tribunals (with links to texts); links to external sources with information about the case, as well as other items.

82 For a detailed analysis of the Convention, see **http://ccsi.columbia.edu/files/2013/08/Mauritius-Convention-Transparency-Paper-formatted-FINAL.pdf.**

83 See e.g. UNCTAD (2015b; 2016c) and Sauvant (2016) for a more elaborate discussion on a permanent appeals facility and world or standing international investment court. The idea is also proposed by the European Union. See e.g. **http://trade.ec.europa.eu/doclib/press/index.cfm?id=1608**.

- **Regularly updated and reliable:** all data presented in the ISDS Navigator has been compiled using a uniform methodology to ensure data comparability (the 'methodological notes' are available on the site). The data has been updated as of the 1st January 2017. While every effort is made to keep information in the ISDS Navigator up to date and complete, the material is provided without any guarantees as to its accuracy or completeness.

The database is freely available to all from UNCTAD's Investment Policy Hub. It will be useful for country officials, policymakers; representatives from the private sector, civil society, law firms, arbitrators, academia, journalists and others with an interest in investment dispute settlement.

The Navigator can be accessed at UNCTAD's Investment Policy Hub: **http://investmentpolicyhub.unctad.org/ISDS.**

Source: UNCTAD.

Because of such and similar other concerns with the perceived increasing abuse of IIAs in favour of investors, there have been calls for a "rebalancing" of investors rights with their obligations and their rights with those of the host country (e.g. Dhar and others 2012). Indeed, recent developments seem to address these concerns in favour of host countries of FDI, both developed and developing countries. In particular, new IIAs tend to have more precise language on FET, MFN and NT, insert labour and environmental clauses which prevent the abrogation of labour and environmental laws in the host country as a modality to attract FDI, expand the general exceptions, increase transparency, predictability and coherence of dispute settlement mechanisms and prevent so-called "forum shopping" for investors (seeking recourse to those mechanisms where they stand the highest chance of winning). Some countries have also withdrawn from BITs or called for their renegotiation, while others are negotiating on the basis of a new template, model BIT that emphasizes host countries' development concerns. India's recently adopted model bilateral investment promotion and protection agreement (BIPA) is an example.[84] Another model as adopted by Brazil seeks to replace the whole notion of investment promotion and protection and instead focuses on cooperation and facilitation: the Brazilian Agreement on Cooperation and Facilitation of Investments (ACFIs). Notably, ACFIs do not include provisions on investor–state arbitration. ACFI negotiations were launched in 2013. Between March and May 2015, Brazil concluded the first three agreements, with Mozambique, Angola and Mexico.[85] UNCTAD's World Investment Report 2016 provides more details on new model IIAs (UNCTAD, 2016c).

Obviously, rebalancing should be proper and not result in discouraging FDI. IIAs should continue to provide proper levels of protection to investors which were after all their original purpose. Box 4.11 discusses various ways for countries to increase their policy space and curb excessive interpretation of investor rights. UNCTAD's roadmap for IIA reform below also refers.

Box 4.11. Legal clauses in IIAs to enhance policy space

There are various ways for developing countries to ensure sufficient policy space in IIAs while maintaining appropriate levels of protection for investors and their investments. A few of them are discussed below.

_ **Positive/Negative list.** Countries can enhance their policy space to opt for positive rather than negative lists. However, in order to deepen the commitments under IIAs and make them broad in scope and coverage, negative lists are preferred. Negative lists are a superior instrument to positive lists and they can perfectly accommodate the legitimate concerns of host countries. Countries that do not wish to make commitments under MFN/NT, prohibition of performance requirements, FET, or any other provision of a BIT in a particular sector, can choose to put the sector on the negative list for all provisions or a particular provision.

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84 The text of the Indian BIPA can be accessed at **http://investmentpolicyhub.unctad.org/Download/TreatyFile/2871**. See also **http://www.nortonrosefulbright.com/knowledge/publications/136918/india-releases-a-new-model-bit.**

85 See for further information **http://www.iisd.org/library/side-side-comparison-brazil-mozambique-and-brazil-angola-cooperation-and-investment**; **https://www.iisd.org/itn/2015/08/04/the-brazilian-agreement-on-cooperation-and-facilitation-of-investments-acfi-a-new-formula-for-international-investment-agreements;** and **https://www.iisd.org/sites/default/files/publications/commentary-brazil-cifas-acfis-mozambique-angola-mexico-malawi.pdf**.

- **Fair and equitable treatment.** A narrow or precise definition can be adopted instead of the standard general formulation (see e.g. NAFTA). BITs can also require a **joint interpretation** (by the treaty contracting parties) of certain clauses or issues subject to a dispute (e.g. ACIA article 40.3; China-Mexico BIT (2008) article 19.2.).
- **Indirect expropriation**. This refers to state measures with the effect of substantially depriving investors of value of the investment comprising of regulatory interference such as the revocation of a license, and erosion of the investor's rights over time through a series of actions. The language of relevant clauses can be made specific to clearly define (restrict or expand) the scope of indirect expropriation and prevent abuse. See for instance annex II of ACIA.
- **Exclusions**: general exclusions or security exclusions, largely based on GATT article XX, are measures that contracting parties can take for purposes such as protecting human, animal and plant life and health; public safety, morals and order; national treasures etc. ACIA article 17 also refers.
- **Essential (security) interests**: Countries can insert a clause that states that obligations entered into by contracting parties do not apply to measures taken by them for protecting their "essential security interests" or "essential interests". Similar to exclusions.
- **Necessity**: International law excludes a State's responsibility for breaching its international obligations in cases of necessity. A high threshold is usually established for invoking "necessity": safeguard essential interest from grave and imminent peril; only way to safeguard the State; conduct must not severely impair an essential interest of another State; cannot be used if the State has itself contributed to the situation of necessity. Similarly, "**emergency**" clauses are found in most BITs.
- **Proportionality**: While countries have recourse to certain escape clauses as noted above, there are certain legal principles that prevent their abuse on the one hand or excessive compensation to investors on the other. One such principle is "proportionality" which demands that a reasonable relationship exists between the effect on the investor and the aim sought to be realized by the State. In disputes, tribunals can take into account public demands and interests in determining proportionality.
- **Police powers**: This principle has no precise definition but may be understood as "*measures essential to the effective functioning of the State.*" What constitutes "effective functioning of the State" can be interpreted broadly, for instance including safeguarding human rights. This doctrine is finding increasing recognition in IIAs.
- **Margin of appreciation**: States to be afforded "latitude" when making decisions about how to resolve conflicts between individual and public rights. This may include a less strict standard in reviewing government measures in times of crisis.
- **Applicable law**: tribunals can invoke existing recognized international law (e.g. ILO or UNESCO conventions) as a body of substantive rules which recognize certain rights in making decisions on the interpretation of BITs (for instance the right of access to water by the public or other essential services or need for protection of a cultural heritage site). See, e.g. ICSID Convention article 42(1), and NAFTA article 1131(1).

The UNCTAD Investment Policy Framework for Sustainable Development also provides suggestions to enhance policy space and make IIAs more aligned with achieving the SDGs (**http://unctad.org/en/PublicationsLibrary/diaepcb2015d5_en.pdf**).

Source: Presentation made by Mr. Rahul Donde, Senior Associate, LÉVY Kaufmann-Kohler, Geneva, Switzerland, on "Investor-State arbitration: substantive and procedural mechanisms for ensuring social justice" at the Regional Seminar on IIAs and Sustainable Development, ESCAP, Bangkok, 1-2 December 2016. Available from **http://www.unescap.org/sites/default/files/4.%20Rahul%20Donde.pdf**.

In any case, the increase of BITs is slowing with the rapid increase in free trade agreements that contain comprehensive investment chapters. Of particular recent interest (or concern) is the Trans-Pacific Partnership (TPP) Agreement that contains deep commitments on investor protection, in particular with regard to ISDS.[86] Similar provisions may enter the Regional Comprehensive Economic Partnership Agreement (RCEP) which is still under negotiation. Other examples include the ASEAN-China Investment Agreement and the ASEAN Comprehensive Investment Agreement or ACIA (box 4.12; see also Chaisse and Jusoh, 2016).

[86] In January 2017, upon assuming office as the United States President, Donald J. Trump withdrew the United States from the TPP which effectively meant the demise of the Agreement. However, TPP set new standards in various areas, including in investment, which are likely to be copied in other agreements, including possibly the Regional Comprehensive Economic Partnership Agreement (RCEP), comprising ASEAN and its leading trading partners in Asia, including China, Japan and the Republic of Korea. However, some of the provisions in TPP, including ISDS, remain controversial. On the 4th February 2016, New Zealand sent a side letter to Australia precluding ISDS under the TPP for their investment relationship.

Box 4.12. The ASEAN Comprehensive Investment Agreement (ACIA)

The ASEAN Comprehensive Investment Agreement (ACIA) entered into force on the 29th March 2012, aiming to create a free and open investment environment through the consolidation and expansion of existing agreements between the ASEAN member countries. In replacing its two precursors, the ASEAN Investment Area (AIA) and ASEAN Investment Guarantee (AIG) agreements, the ACIA attempts to establish a regime based on international best practices while expanding and reaffirming principles set down in the AIA and AIG. In doing so it provides comprehensive and clear definitions in line with existing international agreements, enhancing the attractiveness of ASEAN as a single investment destination.

The ACIA is seen as a key part of the ASEAN Economic Community (AEC) blueprint set down by the regional grouping's member states in 2007, which aims to establish an integrated regional economy with the free flow of both investment and services. The AEC entered into force on the 1st January 2016.

The ACIA covers almost all forms of investment (excluding only the reservations made by members in the ACIA schedule of reservations), with liberalization provisions covering the four main sectors of manufacturing, agriculture, fishery, mining and quarrying, as well as services incidental to these sectors. Liberalization is expected to progress steadily, as member states gradually phase out their reservations regarding investments in certain industries.

The ACIA covers both pre-establishment and post-establishment MFN and NT. It offers eligible investors a number of protections, including fair and equitable treatment, full protection and security, no unlawful expropriation, and free transfer of funds.

In order to benefit from the ACIA an investment must be made by either a natural person (national, citizen, or permanent resident) of any ASEAN country or by an ASEAN-based juridical person that fulfils the requirements laid down in the ACIA. Investment through a recognized juridical person is how investors from outside ASEAN may benefit from the protection granted in the ACIA.

Source: Available from **http://www.aseanbriefing.com/news/2013/04/12/introduction-to-the-asean-comprehensive-investment-agreement.html**.

2. UNCTAD's Road Map for international investment agreements reform

UNCTAD (2012) provided policy guidelines for negotiating IIAs under its Investment Policy Framework for Sustainable Development (IPFSD). In UNCTAD's World Investment Report 2015 (UNCTAD, 2015b), these guidelines were updated under its Road Map for IIA Reform. In the Report, it is argued that before governments undertake IIA reform they should first consider: (a) whether or not to have IIAs in the first place; (b) whether to disengage from IIAs; (c) whether to engage in IIA reform; (d) how to reform IIAs. The choices depend on how useful IIAs generally have been for a particularly host country of FDI. When a country chooses to embark on IIA reform the ultimate objective is to make IIAs more balanced with respect to investor rights to protection and the State's right and responsibility to regulate in the public interest. Such rebalancing can take various forms, e.g.: (a) adding new provisions; (b) omitting certain provisions; (c) clarifying existing provisions and making them more precise, including (d) carving out of certain aspects; (e) linking certain provisions and clarifying where protections offered are subject to certain conditions; (f) calibrating certain provisions, i.e. managing the normative intensity of those provisions; (g) reviewing the institutional framework, including for ISDS; and (h) referring to other bodies of law (e.g. in environment, human rights, public health, etc.).

The Report offers various policy options for reform of MFN, FET, indirect expropriation, public policy exceptions, national security exceptions and ISDS. With regard to ISDS, the options include omitting ISDS from IIAs altogether, improving the arbitral process, establishment of an appeals process, limiting investors' access, using filters for channelling sensitive cases to State-to-State dispute settlement, introducing local litigation requirements as a precondition for ISDS. The possibility of establishing a World Court on Investment is also talked about. Another issue is whether concrete investment promotion and facilitation issues should be covered in IIAs. Of particular importance is the issue of guaranteeing responsible investment in IIAs, which is also discussed in the Report. Finally, the Report discusses the need for system coherence and the need for consolidation of IIAs and coherence of IIAs with other bodies of international law.

In reviewing IIA reform, the following guidelines are particularly important (UNCTAD, 2015a and 2015b):

- When considering the pros and cons of engaging in IIAs, policymakers should have a clear understanding of what IIAs can and cannot achieve. They CAN reinforce investor confidence through appropriate protection clauses and CAN help build and advertise a more attractive investment climate. They CAN lock in reforms and provide stability and predictability in a way that domestic investment laws cannot. They CANNOT turn a bad investment climate into a good one and by themselves they will not be a sufficient determinant of FDI.
- IIAs need to contain carefully crafted scope and definitions of "investment" and "investor", possibly excluding portfolio investment and other short-term or speculative investments from treaty coverage.
- In order to make IIAs work for sustainable development, they need to incorporate stronger provisions to promote responsible investment and business practices, such as the OECD Guidelines for MNEs and the UN Principles on Business and Human Rights. They also need to incorporate clauses that do not undermine host countries' governments to implement and enforce new regulations on social protection and development (including health) and environmental protection, including reduction of greenhouse gas emissions. IIAs should have well-functioning checks and balances, so as to guarantee policy space while avoiding abuse.
- In short, IIAs need to ensure that governments have regulatory space for development.
- IIAs need provisions that shield host countries from unjustified liabilities and high procedural costs of ISDS.
- IIAs need to contain careful definitions of the scope of pre-establishment commitments to give host countries space to attract and direct FDI for sustainable development, including through the adoption of positive and/or negative lists.
- IIAs between developed and developing countries need to incorporate appropriate special and differential treatment for the developing member country.
- MFN and NT need to be carefully defined, possibly excluding ISDS from non-discriminatory treatment, but should not be defined in an excessively narrow manner which would undermine their purpose.
- IIAs need to have a precise definition of fair and equitable treatment and the scope of application of this principle. In particular, the FET clause should be negotiated as an exhaustive list of State obligations (e.g. not to (a) deny justice in judicial or administrative procedures; (b) treat investors in a manifestly arbitrary manner, and (c) flagrantly violate due process, etc.).
- IIAs need to limit the Full Protection and Security provision to "physical" security and protection only and specifying that protection shall be commensurate with the country's level of development.
- Similarly, precise definitions of the application and scope of expropriation needs to be formulated, including clarification of the notion of indirect expropriation. IIAs should limit the scope of a transfer of funds clause by providing an exhaustive list of covered payments/transfers, including exceptions in case of serious balance-of-payments difficulties; and conditioning the transfer right of the investor's compliance with its fiscal and other transfer-related obligations in the host country.
- With regard to ISDS, negotiators need to qualify the scope of consent given to ISDS, promote the use of alternative dispute resolution methods, increase the transparency of procedures, encourage arbitral tribunals to take into account standards of investor behaviour when settling investor-state disputes, limiting resort to ISDS, and increase the role of domestic judicial systems. Obviously, this would include a strengthening of the credibility and competence of the domestic judicial system. Alternatively, IIAs could have no ISDS clause though this would probably undermine the effectiveness of the IIA as an important tool for investor protection and such exclusion is therefore not recommended.
- IIAs should have flexibility for re-negotiation and amendment to allow for their adaptation to changing development contexts and major unanticipated developments.

The full table with policy recommendations and guidelines for IIAs can be accessed at: http://investmentpolicyhub.unctad.org/Upload/Documents/FINAL_WEB_POLICY_FRAMEWORK_30_NOV_2015.pdf.

Table 4.2 shows the Roadmap for IIA reform as contained in UNCTAD (2015b).

Table 4.2. UNCTAD's Road map for IIA reform

Level	Take stock/identify problem	Strategic approach/ action plan	Options for actions and outcomes
National	• National IIA review: ▪ Treaty network and content profiles; ▪ Impact and risk assessment; ▪ Reform needs.	• National IIA action plan: ▪ Design criteria and guidelines; ▪ Reform areas and entry points; ▪ Approaches for IIA reform; ▪ Negotiating strategy.	• New model treaty. • Unilateral termination. • Implementation: ▪ Domestic reform; ▪ Increased awareness; ▪ Improved institutions; ▪ Capacity-building.
Bilateral	• Joint IIA consultations to identify reform needs.	• Plan for a joint course of action.	• Joint interpretation. • Renegotiation/amendment. • Consensual termination.
Regional	• Collective review: ▪ Treaty network and content profiles (regional IIA and BIT network); ▪ Impact and risk assessment; ▪ Reform needs.	• Collective IIA action plan: ▪ Design criteria and guidelines; ▪ Reform areas and entry points; ▪ Approaches for IIA reform and for consolidating and streamlining the IIA network.	• Consolidation/rationalization of BIT networks. • Common model. • Joint interpretation. • Renegotiation/amendment. • Implementation/aid facility.
Multilateral	• Global review of the IIA regime: ▪ Stocktaking/lessons learned; ▪ Identification of systemic risks and emerging issues.	• Multilateral consensus-building on key and emerging issues. • Shared vision on systemic reform.	• Multilateral Action Plan: ▪ Multilaterally agreed criteria and guidelines for systemic reform. ▪ Developing instruments and/or institutions for facilitating reform at all levels. • Multilateral backstopping: ▪ Research and analysis; ▪ Coordination, including "bridging function with other bodies of law; ▪ Technical assistance; ▪ Platform/forum for consensus-building and exchange of best practices.

Source: UNCTAD, table IV.9, page 165 (2015b).

In addition, the International Institute for Sustainable Development (IISD) issued a model international investment agreement in 2005 (Mann, and others 2005), which covers the common clauses found in such agreements but adds provisions on investor obligations, host country rights and obligations and home country rights and obligations. It also covers relations with other international agreements to ensure consistency and contains detailed provisions for ISDS to ensure that it is fair and balanced. The model IIA can be accessed at **http://www.iisd.org/pdf/2005/investment_model_int_agreement.pdf.**

Finally, the International Institute for Environment and Development (IIED) has issued guidelines for making investment contracts fairer and more sustainable (Cotula, 2010). These guidelines can be accessed at: **http://pubs.iied.org/pdfs/17507IIED.pdf.** Updates on trends and issues in relation to IIAs are contained in the UNCTAD IIA Issue Notes which are available at **http://unctad.org/en/pages/publications/Intl-Investment-Agreements—Issues-Note.aspx.**

D. DISCUSSION ISSUES

1. Does your country have a specific foreign investment or investment law? Does your country discriminate between foreign and domestic investors?

2. Does your country have a negative or positive list approach to allowed sectors?

3. What land, property and investment ownership restrictions does your country have on foreign investment? Are these restrictions right, too strict or too flexible?

4. How do you rate your overall rule of law in terms of (a) adequate legal protection for foreign investors; (b) due enforcement. Does your country have a national court and dispute settlement system that meets international standards and expectations?

5. What other laws does your country have that affects or impacts foreign investors and their investments? For instance, what are the relevant clauses for foreign investors in your labour and land laws? Your financial, tax and banking laws? Your mining law, transport and ICT related laws? Laws governing other sectors such as tourism, agriculture, mobile phone operators, e-commerce etc. Are the impacts of these laws considered positive or negative by investors? How can the impact of these laws be made more positive or less negative?

6. Does your country have a proper IPR regime that fits its current development stage? Is it duly enforced? Is there scope for improvement or is this too premature?

7. How many IIAs (in particular BITs) is your country a contracting party to? Do you think these IIAs have helped attract FDI? If so, overall or only in specific sectors?

8. Do you agree with a broad or rather narrow definition of investment? Should your country agree with pre-establishment related MFN and NT clauses or should you retain your right to screen investment proposals?

9. Do you think the current IIA and ISDS regime properly balances investor rights with the state's duty and need for policy space to pursue sustainable development? How could the regime be improved in its contribution to achieving the SDGs?

10. How do you view the relationship between your national legislative framework for FDI and your bilateral and regional legal commitments (under IIAs and RTAs) and multilateral commitments (under relevant WTO laws)? Is there proper alignment? At what level do you think FDI should be best regulated: at national, bilateral, regional or global (multilateral) level?

11. Do you think a Multilateral Framework on FDI and/or the establishment of a World Court on Investment would be necessary or desirable?

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CHAPTER FIVE

5 PERFORMANCE REQUIREMENTS, INCENTIVES AND SPECIAL ECONOMIC ZONES

A. PERFORMANCE REQUIREMENTS

1. Definition, rationale and objectives of performance requirements

Performance requirements are defined as "stipulations, imposed on investors, requiring them to meet certain specified goals with respect to their operations in the host country" (UNCTAD, 2003). Performance requirements have been issued to enhance various development objectives. They are usually used together with other policy instruments, including trade policy, screening mechanisms and incentives. They may cover all aspects of the investment, stretching from the point of FDI entry, subsequent expansion or as a condition for the provision of some kind of advantage (e.g. incentives). Recently, there has been a tendency to rely less on **mandatory requirements** that force an investor to comply with certain conditions as to enter a foreign market and more upon **requirements linked to investment incentives** (Chaisse, 2016a)**.**

Performance requirements are normally used to enhance the contribution of FDI to development. They may also be used to address market or policy failure, information asymmetries, for national security purposes, or to compensate for possible negative externalities associated with FDI such as restrictive business practices. The evidence of their effectiveness is mixed. While some argue that performance requirements can be a powerful policy tool for development, others find that their contribution to development is very limited or zero and that they may even be counterproductive and act as a disincentive for FDI (see section 2 below).

In particular, the following (non-exhaustive) objectives of performance requirements can be identified:

- Strengthening the industrial base and increasing domestic value added;
- Generation of domestic employment opportunities;
- Linkage promotion (of TNCs with domestic enterprises);
- Export generation and performance;
- Trade balancing;
- Subnational regional development promotion;
- Technology transfer;
- Avoidance of restrictive business practices;
- Generation and distribution of rents;
- Various non-economic objectives, such as political independence and distribution; of political power (UNCTAD, 2003).

Typical examples of performance requirements are:

- Trade-related, e.g. local content, export performance, import restrictions;
- Joint venture/ownership and equity requirements;
- Employment related, e.g. mandatory hiring of local labour, managers;

- Training related: mandatory training of local staff;
- Technology transfer;
- R&D;
- Establishment of corporate headquarters;
- Community work, CSR and compensation.

A more comprehensive categorization of performance requirements is contained in table 5.1.

Table 5.1. Categories of performance requirements

Category	Performance requirement
Prohibited by the WTO Trade-Related Investment Measures (TRIMS) Agreement.	• Local content requirements; • Trade balancing requirements; • Foreign exchange restrictions; • Export restrictions; • Quantitative restrictions; • Requirements that violate national treatment.
Prohibited, conditioned or discouraged by international investment agreements at bilateral or regional levels.	• Requirements to establish a joint venture with domestic participation; • Requirements for a minimum level of domestic equity participation; • Requirements to locate headquarters of a TNC in a specific region; • Employment requirements; • Export requirements; • Restrictions on sales of goods or services in the territory where they are produced or provided; • Requirements to supply goods produced or services provided to a specific region exclusively from a given territory; • Requirements to act as the sole supplier of goods produced or services provided; • Requirements to transfer technology, production processes or other proprietary knowledge; • Research and development requirements; • Requirement to source a minimum of inputs required for the production of a good from local suppliers.[87]
Not restricted.	All other performance requirements (e.g. training, CSR, mandatory capital investments).

Source: UNCTAD (2003).

2. Do performance requirements work?

The use of performance requirements and their impact is closely linked to the perception of FDI in development. In any case, it can be argued that though performance requirements are rationalized as tools to address market failure, it is rather the performance requirements that have the potential to operate as market distortions, causing firms to behave otherwise than how they would choose to behave in the absence of such requirements (Collins, 2015). In practice, the evidence of the impact of performance requirements is not clear cut and tends to be very situation-specific. In general, countries that insist on performance requirements tend to have not the most conducive investment climate to start with and performance requirements will be viewed by investors as a further obstacle. Countries with a superior investment climate do not need performance requirements as the national legal and regulatory framework and quality of domestic enterprises ensures that FDI does indeed contribute to development. However, a case can be made to link performance requirements as a condition to receive incentives and the two concepts have become increasingly interlinked (Collins, 2015).

[87] The WTO-TRIMS Agreement prohibits local content requirements for export goods. However, when the production is for domestic consumption only, governments can require foreign investors to source a minimum of their inputs required for the production of a good from local suppliers or a subgroup of local suppliers such as SMEs.

With regard to specific performance requirements, the evidence is also mixed but tends to be generally negative. Most of the research in this area is rather old. Some studies quoted in UNCTAD (2003) showed that "local content requirements have been effectively used to overcome information asymmetries and other market failures to prompt TNCs to source locally, license the local manufacture of components that it may not do otherwise, identify nascent local capabilities and provide them with know-how and technology."

Other studies showed that local content requirements are a costly and inefficient policy tool. For instance, Moran (1998) finds that domestic content requirements are usually applied in highly protective markets and are "not only extremely costly, but also quite ineffective as an infant-industry tactic to demonstrate the underlying appeal of a given host to multinational corporations. [...] The imposition of high domestic-content requirements in protected markets tends, moreover, to generate a perverse political economy in which the foreign investors themselves frequently join domestic forces in opposing further liberalization of trade and investment." Moran's study focused on three sectors: automotive, petrochemicals and computers.

However, when foreign investors are determined to invest in a particular location for strategic reasons, domestic content requirements may have a positive though non-intended effect. For instance, when the Government of Thailand imposed local content conditions on the Japanese automotive industry to develop the indigenous car supply industry[88], the regulation was followed by an influx of FDI from Japanese car suppliers that offered supplies at the required quality which Thai SMEs could not match (ITC, 2010; Techakanont, 2011). Thus, while the objective of the Government of Thailand was to develop local SMEs through forging vertical backward linkages, it did not achieve that objective though the effects of the policy were still positive as it resulted in additional FDI inflows and a limited number of joint ventures between Japanese and Thai SMEs (horizontal linkages). The recent domestic content requirements as a condition for liberalization of FDI in multi-brand retailing in India have not led to an increase in FDI in the sector (box 5.1), though local content requirements in Viet Nam showed some positive results (box 5.2). China has been more successful in developing solar PV and wind power sectors making extensive use of local content and technology-transfer requirements (Mazzucato, 2015) but investors may accept those requirements as a cost of doing business in a very lucrative market.

With regard to export performance requirements Moran finds more positive evidence. In particular, he finds (with regard to the same three sectors) that export performance requirements have pushed TNCs to incorporate sites in developing countries and countries with economies in transition in their international sourcing strategies. UNCTAD (2003) cites the positive experience of Malaysia where export performance requirements seem to have helped the country succeed in expanding exports of electronic components. Of course, it can be argued that in case TNCs have the intent to select sites for export purposes anyway and given the incentives that they may receive which are coupled to the requirements and/or availability of required infrastructure provided by EPZs, it would still make economic sense for TNCs to select sites in countries that apply export performance requirements. In other words, TNCs select the site *despite* the requirements. And also in that case, the TNC may have satisfied export performance expectations even without the requirements. In any case, most export performance requirements are now prohibited by the WTO and by many IIAs as they distort market forces and international trade and investment leading to inefficiencies in resource allocation.

Box 5.1. India's local content requirements for FDI in multi-brand retail

India has traditionally not had a positive view of FDI and the liberalization of investment has moved slowly. In recent years, India has followed the global trend of promoting and attracting FDI for development. With regard to retail, India has generally protected its domestic industry, in particular its SME sector. In 1997, the Government approved 100% of the FDI in "cash and carry" wholesale stores under the automatic route and, in 2006, 51% FDI was allowed in single-brand retailing, although with prior approval from the Government. In December 2011, the Government fully opened up FDI in single-brand retail stores. This was followed by an announcement in September 2012 to allow 51% foreign-owned multi-brand retail businesses, such as Walmart, Carrefour and Tesco. This policy came into effect in 2013 after many years of delays. The principal reason for the delay was fear that foreigners would dominate retail trade and crowd out domestic SMEs, leading to unemployment and poverty.

88 The local content requirements were in effect from 1975 to 1999.

The policy, however, came with many strings attached. The 51% foreign investment would only be allowed upon government approval, and would need to satisfy the following conditions: a minimum investment of $100 million, a 50% investment in back-end infrastructure (distribution centres, warehousing and logistics) within three years, a 30% mandatory procurement of products sourced from small industries. The investment would only be allowed in cities with a population of one million or more. At the same time, individual states would have the discretion to implement or not to implement the policy. Following the policy, little FDI in retail has flowed to India. The current administration, previously against the policy, has maintained it and further liberalized the provisions. For instance, foreign retailers will now be allowed to open stores in cities that have a population of less than one million. Sourcing requirements were also relaxed a bit. At the same time, however, the Government tightened control by foreigners of joint ventures.

Various studies have indicated that liberalization of FDI in retail poses no problem for Indian (see Singh, 2013). In fact, FDI would lead to better infrastructure, better quality products for consumers, upgrading of domestic suppliers, better logistics and less wastage of food products. Experiences in other countries have also shown that though FDI in retail can have a disruptive effect on mom-and-pop stores, the impact has been limited (Reardon, and others, 2012). Foreign supermarkets tend to be on the outskirts of cities rather than in the inner city and cater to a different customer segment. Perhaps there are exceptions in the case of FDI in small supermarkets, such as the 7-Eleven chain, but in many cases local small groceries have managed to adapt and survive.

Realizing the benefits that FDI in retail can bring, it is understandable that the Government of India has liberalized investment. However, the stringent conditions imposed on such FDI may be counterproductive while persisting high real estate costs continue to be another hurdle. Foreign investors would automatically source from local suppliers if the products fit their quality requirements as sourcing locally is per definition cheaper than imports. However, if local suppliers do not meet these quality requirements, then foreign investor cannot risk undermining their global brand reputation. They would prefer not to invest at all. Not surprisingly, India has not witnessed a large inflow of FDI in retail in recent years. The Government has now announced that it will allow 100% FDI in multi-brand retail in the food industry. Also in June 2016, the Government relaxed the 30% local content rule for single brand retailers by granting a three-year reprieve, extendable to five years, for products that were considered “state of the art” and “cutting edge” technology, a relaxation that could help companies such as Apple and Ikea.

Source: Available from **http://www.moneycontrol.com/news/real-estate/fdimulti-brand-retail-hopeabeyance_1020882.html**; **http://timesofindia.indiatimes.com/business/india-business/FDI-rules-in-multi-brand-retail-eased/articleshow/21541870.cms**; Singh (2013).

Box 5.2. Viet Nam’s localization policy in the motorcycle sector

Localization refers to the strategy of a company or government policy to reverse the fragmentation associated with global value chains and maintain or attract as much of the production and services associated with a given value chain in one particular country or location. Governments often resort to high import tariffs and local content rules to optimize localization which is expected to contribute to local employment, value-added and technology transfer. The success of localization depends on the capacity of the country or location to produce all or most of the required parts and components and to deliver all the required services of the required quality in a required time period. In practice this rarely happens, in particular with regard to products which in their end state are technologically rather sophisticated.

Many countries in Asia have pursued localization strategies. In South-East Asia, localization policies were particularly prominent in the automotive and motorcycle sectors though the WTO TRIMS Agreement curtailed or prohibited these policies. Normally, localization starts with a prohibition of completely built units (CBU) and forcing local manufacturers – typically foreign investors – to import motorcycles in completely knocked down (CKD) form. In the second phase, import restrictions on parts and components force companies to use locally produced parts and components thereby developing the industry in the host country of foreign investors. The production of locally produced parts and components initially takes place by foreign supplier investors, both first and second tier, and then will hopefully move to local producers. In practice, local producers may not have the technology or skills to meet the stringent standards and quality requirements so that production of parts and components as well as the final assembly remains in the hands of foreign investors.

Following the localization practices in Indonesia, Malaysia and Thailand, Viet Nam started a localization policy in 1996 in the motorcycle industry with the prohibition of CBU. Until that year, most motorcycles in the country were used motorcycles imported from Japan. Subsequently, most motorcycles were imported in CKD form, increasingly from China and Taiwan Province of China, which enjoyed a price advantage over Japan. In the early 2000s the Government of Viet Nam introduced import controls on the import of parts and components followed by restrictions on motorcycle registration and limits on investments for the expansion of production capacity by foreign motorcycle manufacturers from 2003 while a minimum of 20% of local content had to be achieved by in-house manufacturing of key components.

Domestic assembly companies were not subject to the same restrictions. This caused massive damage to foreign investors and the production of motorcycles in the country plummeted. In the period 2005-2008, the restrictions were eased and phased out with Viet Nam's entry into WTO.

Viet Nam's localization policy seems to have contributed to the growth of the domestic motorcycle sector, consisting of a mixture of foreign investors and domestic companies. In 2005, Mishima (2005) reported that Honda Viet Nam achieved a local content of 81%. Thuy (2007) reports local content rates of 70-80% in the motorcycle sector in various kinds of models. However, Moran (2011) notes that the localization policy in Viet Nam was an exception, proving the rule that performance requirements are counterproductive: "Honda, Yamaha and Suzuki found it profitable to help local suppliers produce large batches of technologically simple components for foreign assemblers in the fast-growing domestic motorcycle industry, thereby reaching local content levels above 40%." But, according to Moran, the local content requirements had been arbitrarily set at 60% which were never met by foreign assemblers.

Sources: Mishima (2005); Thuy (2007); Fujita (2011); Moran (2011).

Moran also finds that joint ventures are usually preferred by foreign investors who are not familiar with the market conditions and local culture and need a partner to navigate the rules and regulations and interact with the government. Under such conditions, it is not necessary to make joint ventures a requirement. In those cases where foreign investors are perfectly aware of the local conditions, culture and regulatory framework and where local partners are generally perceived as weak, a requirement for joint ventures would be counterproductive. The issue of joint venture was discussed in chapter 3 which also outlined the conditions for a successful joint venture.

With regard to technology transfer requirements, Moran (1998, 2011) cites the "Korea Model" or "Japan-Korea" model with the following key ingredients:

- Import restraints coupled with aggressive export promotion;
- Promotion of national champions in targeted sectors through fiscal subsidies and other preferential treatment;
- Severe restrictions on FDI with aggressive insistence on technology sharing, licensing and transfer arrangements, leaving control in national hands.

The model seems to have helped both the Republic of Korea and Japan develop very rapidly with relatively high shares of R&D in GDP without FDI and with the help of the process of "reverse engineering" and a very enabling environment for domestic business, usually large conglomerates (called "chaebols" in the Republic of Korea). After the 1997 Asian Financial Crisis, the model changed to active FDI promotion under a liberalized trade and investment regime. In any case, due to WTO agreements, RTAs and IIAs, such a model will be difficult to follow for most open developing countries today. Even today, FDI in the Republic of Korea and Japan remains rather constrained. Chapter 3 discussed the issue of technology transfer through FDI and found that such transfer is not automatic and probably not any better under performance requirements. Rather, by offering a superior domestic business climate and national innovation system, higher level FDI would be encouraged to invest, not only in production capacity but also in training and R&D facilities if a strategic advantage could be derived. In other words, foreign investors will transfer technology if it is in their advantage to do so. It is up to national governments of host countries (and their IPAs) to understand the nature and objectives of foreign investors and to anticipate their demands and requirements to get the maximum benefits out of them.

Mandatory minimum investment requirements are strictly speaking not a performance requirement but they are a condition for investment that is linked to a certain performance (i.e. contributing to external capital flows). While such requirements can serve the legitimate objective of ensuring high-quality investments, they also tend to discourage private investment, including potentially valuable small investments, particularly those in non-capital – intensive businesses in the services sector (Daniel and Forneris, 2010).

A case can be made for mandatory performance requirements that stress sustainability. While appropriate national laws and regulations are still a superior way to ensure sustainability, it could be acceptable in principle to demand from investors that they conform to internationally recognized principles and standards related to responsible business conduct and CSR, including (a) OECD guidelines for MNEs; (b) UN guiding principles on business and human rights; (c) UN Global Compact; (d) ILO conventions on decent work, including Tripartite Declaration of principles concerning multinational enterprises and social policy (MNE Declaration); environmental assessments and pollution control, benefit sharing in natural resources, and abstain from political meddling and peddling to vested local interests. However, similar issues can also be (and perhaps better) addressed in BITs or

investment contracts between governments and foreign investors. Such agreements increasingly prohibit common performance requirements as discussed above but increasingly address social and environmental issues (see chapter 4). They also contain provisions that replace some performance requirements. For instance, rules of origin contained in most RTAs specify local content conditions for preferential trade access. For an overview of performance requirements in IIAs, see Nikièma (2014).

3. Conclusions

Performance requirements seem to work best in a competitive environment, while in protective environments they lead to development inefficiencies. Generally, however, they are often found to be ineffective to achieve development goals and they are increasingly being replaced by trade policy instruments. Of course, countries which otherwise offer investors a carrot in the form of incentives or access to scarce resources are in a better bargaining position to request performance requirements. Of all possible requirements, technology transfer requirements are the least likely to succeed and in some cases the insistence on performance requirements may lead to a failure to attract FDI at all. World Bank institutions routinely advise against them (e.g. Daniel and Forneris, 2010) and they distort the effective functioning of market forces. In the end, ensuring a conducive business and investment climate is best. Countries that do not have such a climate will not attract FDI with performance requirements unless generous incentives are granted. But in that case, it can be argued that the net benefit to the country may be negative.

It should also be kept in mind that most investors in today's world take a global view. In other words, why invest in a country that imposes performance requirements if a similar investment can be made in a country that doesn't? In today's competitive environment, insisting on performance requirements may result in losing the investment altogether. Also, the performance of the enterprise depends on the value it can derive from the local investment. If performance requirements undermine that value, the investor will simply not invest as it does not make good business sense. In other words, performance requirements will have to fit into the business strategy and should not undermine its overall goals. Performance requirements therefore will have to be realistic. Insisting on the transfer of a technology which would undermine the intellectual property rights of an investor will not be realistic. Asking investors to source a minimum of their inputs from local sources when such sources are perceived to produce substandard inputs will affect the investor's reputation and, hence, the investment may not be made. In most cases, such requirements are redundant. For instance, if local producers produce quality inputs it would not make sense for investors to source such inputs from abroad. They would therefore automatically source from local producers without performance requirements. In conclusion performance requirements "must reflect a fair balance to produce effects without jeopardizing the economic viability of investments" (Bernasconi-Osterwalder and Rosert, 2014).

Generally, the net positive impact of performance requirements is the greatest if:

- Their objectives are clear (and are economic, not political);
- Governments have capabilities to implement and effectively monitor and evaluate them;
- They are supported by complementary policies conducive to investment;
- They do not replace efforts to improve business climate and develop competitiveness;
- There is local capacity to absorb learned skills, technologies transferred, provide staff for R&D etc;
- Domestic enterprises have strengths to engage in joint ventures;
- They are compatible with other industrial/trade policies;
- They are linked to incentives.

B. INVESTMENT INCENTIVES

1. Investment incentives: definitions, rationale and typology

Investment **incentives** can be defined as "measurable economic advantages that governments provide to specific enterprises or groups of enterprises, with the goal of steering investment into favoured sectors or regions or of influencing the character of such investments. These benefits can be fiscal (as with tax concessions) or non-fiscal (as with grants, loans, or rebates to support business development or enhance competitiveness)" (James 2009, 2013). OECD (2003) defines incentives as "measures designed to influence the size, location or industry of

an FDI investment project by affecting its relative cost or by altering the risks attached to it through inducements that are not available to comparable domestic investors." Many governments use incentives to attract FDI and also to promote domestic investment. There are multiple reasons why governments provide incentives for domestic or foreign investment. Below are some of the main reasons (Loewendahl, 2009):

- To overcome a competitive weakness such as high costs of doing business or overall weak business climate (so-called site equalization outlays);
- To promote investment in relatively underdeveloped, deprived and poorer areas;
- To attract particular industries;
- To correct for market failures in the provision of capital and risk-taking of companies;
- To change the image of a location to make it pro-business.

There are various ways to categorize incentives. In the United States, a distinction between **statutory** and **discretionary incentives** is common, and not particularly linked to FDI. National or Federal statutory incentives are available to any business that meets stated eligibility criteria. Discretionary incentives are customized and provided in case of a disproportionally large investment project or by certain communities, and only in relation to specific projects. In almost every case, discretionary incentives come into play when a community is trying to attract a large business operation that brings significant investment (and, hence, jobs and revenue) into that community.

Another distinction is between **fiscal** and **non-fiscal** incentives. Fiscal incentives consist of tax holidays or exemptions, import duty exceptions or preferences, but can also constitute subsidies or grants. Non-fiscal incentives include preferential access to land, labour, capital, utilities, infrastructure etc. Non-fiscal incentives comprise of **regulatory incentives** which refer to "policies of attracting foreign-owned enterprises by means of offering them derogations from national or sub-national rules and regulation" (OECD, 2003).

The World Bank defines **fiscal or tax** incentives as "policies that are designed to reduce the tax burden of a firm" (including loss write-offs and accelerated depreciation) as distinct from **financial** incentives which are defined as "direct contributions to the firm from the government" (including direct capital subsidies, subsidized loans or dedicated infrastructure) (World Bank, 2003). However, as an IISD study (2007) notes, "determining when a subsidy is an investment incentive is not always straightforward. Both intent and specificity are important in deciding when a subsidy is an investment incentive. Many incentives consist of 'packages' of different types of subsidies, all contingent on the company making an investment."

OECD (2003) distinguishes **rules-based approaches** to incentives that rely on discrimination (according to nationality) of investors to be stipulated by law, and **specific approaches** that tailor incentives to individual foreign investors or investment contexts though the dividing line is often blurred. Specific approaches tend to lead to a multitude of different incentives, including specially negotiated fiscal derogations, grants and soft loans, free land, job training, employment and infrastructure subsidies, product enhancement, R&D support and ad hoc exceptions and derogations from regulations.

Probably the most common typology is provided by the Investment Climate Advisory Services of the World Bank Group (Daniel and Forneris, 2010) based on earlier research undertaken by them (table 5.2). Globally, including in Asia and the Pacific, the fiscal or tax incentive is by far the most common, while accelerated depreciation and allowances for training and R&D are also used (UNCTAD, 2000). However, generally financial incentives often face legal restrictions (in particular if they are "contingent on export performance" which are prohibited by WTO). Tax incentives such as tax holidays are perceived, often wrongly, to be easier to administer than performance-based incentives.

The most comprehensive source of global incentives can be found at **www.incentivesmonitor.com.**

This website contains the only database, developed by WAVTEQ, tracking globally incentives packages awarded to companies for specific projects and related incentives policies.

While originally outward FDI was often viewed as exporting jobs and capital at the detriment of the national economy, increasingly emerging and larger more developed countries are also using incentives to promote outward FDI. This would fit Porter's paradigm on strengthening national competitive advantage as outward FDI would help domestic business to strengthen international competitiveness, for instance through cutting costs and/or accessing skills and technologies that are not available at home. Incentives for outward FDI are different from those used to attract inward FDI although there are similarities in the types of incentives used (i.e. financial and

Table 5.2. Investment incentives typology

Type	Examples
Regulatory (exemptions from specific rules and regulations)	• Easing of environmental requirements; • Exemptions from certain labour requirements; • Exemptions from performance requirements; • Exemptions from land ownership criteria.
Financial	• Infrastructure subsidies; • Job-training subsidies; • Relocation and expatriation support; • Administrative assistance; • Temporary wage subsidies such as: ▪ credits to investors; • real estate subsidies; • direct and indirect cost participation (for example, marketing, development, operating, supply of goods, and supply of services).
Fiscal (tax)	• Reduced corporate taxation, particularly: ▪ reduced rates of corporate income tax; ▪ tax holidays; ▪ special tax-privileged zones. • Incentives for capital formation such as: ▪ special investment allowances (for example, accelerated depreciation, enhanced deductions); ▪ Investment tax credits; ▪ Allowances on reinvested profits. • Reduced impediments to cross-border operations such as: ▪ exemption from withholding tax; ▪ exemption from trade taxes (for example, reduced import and export taxes and customs duties); ▪ exemption or lowered taxation of employees (for example, lower personal income tax, social security reductions for expatriate executives and employees); • Other tax reductions (lower sales tax, VAT reductions, property tax).

Source: Daniel and Forneris (2010).

fiscal, regulatory, informational and technical, institutional). Incentives for outward FDI include risk-minimizing measures (political risk and credit risk insurance) which are not typical incentives for inward FDI.[89] Sauvant and others (2014) describes home country measures for outward FDI in more detail.

2. Incentives: do they work?

The effects of incentives are not uniform and depend on the type of incentive and the circumstances of the country offering them. Table 5.3 shows some of the advantages and disadvantages of fiscal and financial incentives which are the most common.

Collins (2015) observes that on the one hand investment incentives may distort markets and encourage investors to allocate capital to less efficient investment projects, i.e. capital that could be more productively invested in other projects or other countries. Incentives also drain public funds that could be disbursed to provide essential public goods and services. In other words, investment incentives carry significant opportunity costs. On the other hand, he observes that incentives can address market failure and information asymmetries and that

[89] For a discussion on incentives on outward FDI, see Johnson and Toledano's background (draft) paper (box 1) for the Eighth Columbia International Investment Conference on Investment Incentives: The good, the bad and the ugly; Assessing the costs, benefits and options for policy reform. 13-14 November 2013. Columbia University. The paper can be accessed at: **http://ccsi.columbia.edu/files/2014/01/VCC_conference_paper_-_Draft_Nov_12.pdf.**

Table 5.3. Advantages and disadvantages of fiscal and financial investment incentives

Advantages	Disadvantages
Lower corporate income tax rate on a selected basis	
• Simple to administer. • Revenue costs more transparent.	• Largest benefits go to high-return firms that are likely to have invested even without incentive. • Could lead to tax avoidance via transfer pricing (intra-country and international). • Acts as windfall to existing investments. • May not be tax spared by home country tax authorities.[90]
Tax holidays	
• Simple to administer. • Allows taxpayers to avoid contact with tax administration (reducing chance for corruption).	• Similar to lower corporate income tax rates, except that it might be tax spared. • Attracts projects of short-term maturity. • Could lead to tax avoidance through the indefinite extension of holidays via "re-designation" of existing investments as new investments. • Creates competitive distortions between existing and new firms. • Costs are not transparent unless tax filing is required, in which case administrative benefits are foregone.
Investment allowances and tax credits	
• Costs are relatively transparent. • Can be targeted to certain types of investment.	• Distorts the choice of capital assets towards projects of short-term maturity since an additional allowance is available each time an asset is replaced. • Qualified enterprises might attempt to abuse the system by selling and purchasing the same assets to claim multiple allowances. • Greater administrative burden. • Discriminates against investments with delayed returns if loss carry-forward provisions are inadequate.
Accelerated depreciation	
• Similar benefits to investment credits and allowances. • Generally does not discriminate against long-lived assets. • Moves the corporate tax closer to a consumption-based tax, reducing the distortion against investment typically produced by the former.	• Some administrative burden. • Discrimination against investments with delayed returns if loss carry-forward provisions are inadequate.
Exemptions from indirect taxes (VAT, import tariffs, etc.)	
• Allows taxpayers to avoid contact with tax administration (minimizing corruption).	• VAT exemptions may be of little benefit (under regular VAT, tax on inputs is already creditable; outputs may still get taxed at later stage. • Prone to abuse (easy to divert exempt purchases to unintended recipients).
Export Processing Zones	
• Allows taxpayers to avoid contact with tax administration (minimizing corruption).	• Distorts locational decisions. • Typically results in substantial leakage of untaxed goods into domestic market, eroding the tax base.

Source: Fletcher (2002) as quoted in Rajan (2004).

[90] This refers to the tax sparing credit (i.e. the direct dollar-for-dollar reduction of an individual or company's tax liability) which is a term to denote a special form of double taxation relief in tax treaties with developing countries. Where a country grants tax incentives to encourage foreign investment and that company is a resident of another country with which a tax treaty has been concluded, the other country may give a credit against its own tax for the tax which the company would have paid if the tax had not been "spared" under the provisions of the tax incentives (**http://definitions.uslegal.com/t/tax-sparing-credit**).

incentives can help direct investment in underserved markets. Incentives can also help mitigate negative externalities, such as environmental damage.

The Investment Climate Advisory Services of the World Bank Group (Daniel and Forneris, 2010) has pointed out that tax holidays in countries with poor investment climates are counterproductive as such incentives would never compensate for the poor investment climate and governments lose revenue that could have been used to improve the investment climate. Generally, the costs of tax holidays outweigh the benefits. Apart from revenue loss, the following costs are associated with incentives (James, 2009, 2013):[91]

- Distortion costs created by encouraging new investments that are detrimental to existing ones;
- Time and money spent by business to lobby the government for incentives;
- Time and money spent by business to qualify for and receive incentives;
- Revenue lost due to illegal activity, such as from businesses that do not qualify for tax exemptions but falsify information to do so, or indirect revenue lost to businesses that do not qualify for tax incentives but illegally use tax-exempt entities to source goods;
- Additional costs for tax authorities responsible for administering the incentives.

In particular, tax holidays may have the following negative consequence (Daniel and Forneris, 2010) (see also table 5.3):

- Firms have an incentive to close down and sell their business at the end of the tax holiday, only to reopen as a “new” investment, thus gaining an indefinite tax holiday.
- Tax holidays provide no incentive for growth and compare unfavourably to investment-linked incentives.
- With most foreign investors operating under double taxation agreements, tax holidays (in the absence of tax sparing) simply lead to a transfer of tax revenues from the country receiving the investments to the home country.
- Tax holidays threaten the existing tax base by allowing firms to funnel profits, via transfer pricing, from an existing profitable company through the “tax holiday” company and therefore avoid paying taxes on either.
- Most capital-intensive investments do not yield a profit for the first several years of operation so tax holidays for a “start-up” period of, for instance, five years are ineffective. In fact, in such cases tax liabilities kick in just about when businesses start to make a profit.
- Tax incentives for FDI may displace domestic investment encouraging roundtripping (IMF and others, 2015).

As the Investment Climate Advisory Services of the World Bank Group (Daniel and Forneris, 2010) notes, performance-based and export-based incentives are superior instruments but the costs have to be weighed against the benefit of the investment for the host country. In addition, “all else being equal, export-based incentives are effective in attracting mobile investments such as in textiles, but these investments have limited backward linkages to the local economy and are usually quick to leave when the tax break is withdrawn”.

The extent to which incentives play a role in the investment location decision depends very much on the motivation of the investor. The literature and empirical research findings provide mixed results[92] While incentives matter in developed countries (e.g. De Mooij and Ederveen, 2008), they have generally less effect in attracting FDI in developing countries (see for instance Thomas, 2007 for an overview). James (2009, 2013) and Investment Consulting Associates (2013) report that the level of taxation on FDI matters in developed countries with more or less similar investment climates but that incentives matter less in developing countries where incentives cannot compensate for an otherwise poor investment climate (see also e.g. Chaisse, 2016b; Kinda, 2014). James and Van Parys (2009) and Abbas and Klemm (2013) find that incentives matter in developing countries but that the effect is relatively small. Loewendahl (2013) also finds that incentives and taxes matter but not greatly in attracting FDI to individual states in the United States (markets and skills are much more important) and that they matter more for manufacturing projects than for R&D projects. Mutti and Grubert (2004) find that export-oriented FDI is

[91] Available from **http://www.imf.org/external/np/seminars/eng/2014/caribbean/pdf/S2p2-James.pdf**.

[92] Some of the references quoted in this paragraph are from a report to the G20 Development Working Group prepared by the IMF, OECD, United Nations and World Bank, called: “Options for low income countries’ effective and efficient use of tax incentives for investment (IMF and others, 2015).

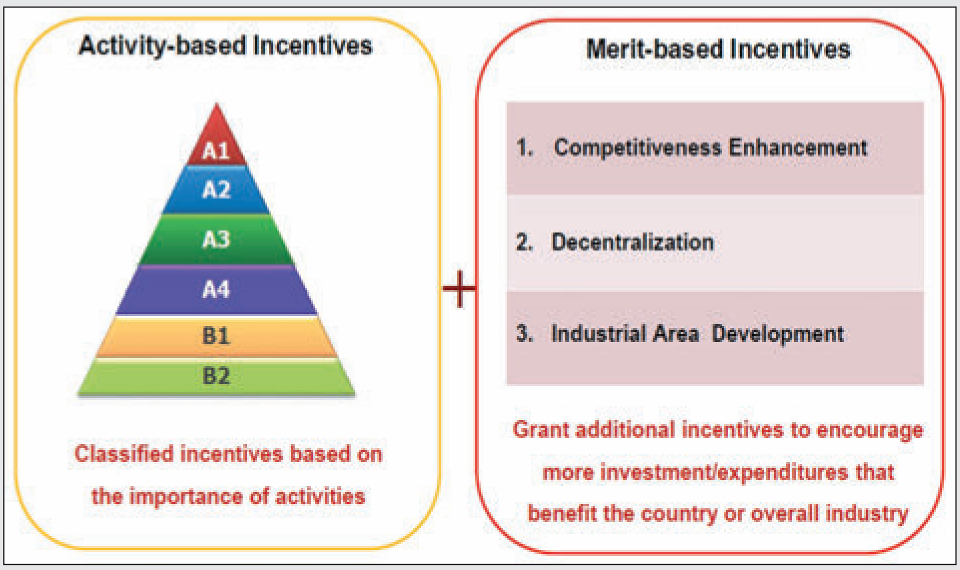
more sensitive to tax incentives than domestic-market oriented FDI. Therefore, incentives may sometimes be important for efficiency-seeking FDI (per definition export-oriented) as foreign investors engaged in global value chains do pick locations that stand out in some way or another, other factors being equal. Incentives do not play an important role in the mining and natural resource sector (James, 2009, 2013) where governments should raise revenue from FDI rather than lose revenue for an investment that is location-based and would have been made in any case. Similarly, they play a minor role for market-seeking and strategic-asset seeking FDI though the importance differs for different sectors and different investors. Also in the case of FDI in capital-intensive sectors such as automobiles and semi-conductors, the availability of subsidies is sometimes essential (Thomas, 2007). In those cases, the level of incentives offered can be the final straw in the investment location decision.

There is also an ongoing debate on whether incentives should be broadly available or tailored towards serving a specific purpose or stimulating sector based activities (see box 5.3). In this regard, it can be observed that statutory, discretionary, general or sector-specific incentives rarely turn a poor location into an acceptable one. Therefore, companies normally look at them only after a number of locations have been identified that satisfy a company's key operation requirements. But among roughly equal alternatives, incentives can represent a decisive factor. While intuitively incentives may play a bigger role for small-scale investors than for large-scale investors, actually they may matter more for large-scale investors, possibly because of minimum investment requirements and high upfront costs to get the incentive.

Box 5.3. Thailand's new approach to granting incentives

Under Thailand's Board of Investment (BOI) 7-Year Investment Promotion Policy (2015-2021), the country promotes: (a) investment that helps enhance national competitiveness by encouraging R&D, innovation, value creation in the agricultural, industrial and services sectors, SMEs, fair competition and inclusive growth; (b) activities that are environment-friendly, save energy or use alternative energy to drive balanced and sustainable growth; and (c) clusters to create investment concentration in accordance with regional potential and strengthen value chains; and promotes special economic zones, especially in border areas, both inside and outside industrial estates, to create economic connectivity with neighbouring countries and to prepare for entry into the ASEAN Economic Community (AEC). For that purpose, the BOI has shifted its incentive policy from location-based incentives ("zones") to activity- and merit based incentives as illustrated in figure 5.1. (See also box 5.16 for incentives linked to SEZs).

Figure 5.1. Shifting investment incentive policy in Thailand



Source: Board of Investment, Thailand.

The use of tax incentives in particular has increased in popularity among policymakers of developing and emerging economies. Most countries face pressure to offer more generous tax incentives in order to compete with similar incentives offered in neighbouring countries, while most governments are also under pressure to cut budgets and divert tax revenues towards spending on public goods and services. The justification of tax

incentives conflicts with the key objective of tax policies i.e. to generate tax revenues and income for a government. Thomas (2007) notes that tax incentives are subsidies to capital which undermine the three “E’s”: efficiency, equity and (business) environment. Generally, the use of investment tax allowances (ITA), investment tax credits and accelerated depreciation is preferable to tax incentives.[93] Malaysia is an example of a country that uses ITA alongside other tax incentives (box 5.4).

Box 5.4. Main tax incentives for manufacturing companies in Malaysia

Like in virtually all countries, the incentive schemes for foreign (and domestic) investments are complex and consist of various mechanisms. With regard to main tax incentives for manufacturing companies in Malaysia the major tax incentives for companies investing in the manufacturing sector are the Pioneer Status and the Investment Tax Allowance (ITA).

Eligibility for Pioneer Status and ITA is based on certain priorities, including the level of value-added, technology used and industrial linkages. Eligible activities and products are termed as “promoted activities” or “promoted products”. A list is available on the MIDA website.

Pioneer Status

A company granted Pioneer Status enjoys a five-year partial exemption from the payment of income tax. It pays tax on 30% of its statutory income (which is derived after deducting revenue expenditure and capital allowances from the gross income), with the exemption period commencing from its Production Day (defined as the day its production level reaches 30% of its capacity).

Unabsorbed capital allowances as well as accumulated losses incurred during the pioneer period can be carried forward and deducted from the post pioneer income of the company.

Investment Tax Allowance

As an alternative to Pioneer Status, a company may apply for ITA. A company granted ITA is entitled to an allowance of 60% on its qualifying capital expenditure (factory, plant, machinery or other equipment used for the approved project) incurred within five years from the date the first qualifying capital expenditure is incurred.

The company can offset this allowance against 70% of its statutory income for each year of assessment. Any unutilized allowance can be carried forward to subsequent years until fully utilized. The remaining 30% of its statutory income will be taxed at the prevailing company tax rate.

Additional incentives for manufacturing comprise the reinvestment allowance and accelerated capital allowance. Specific incentive schemes apply to selected sectors such as automobiles, small and medium-sized enterprises, agriculture, biotechnology, and the utilization of oil palm biomass.

Application for various incentive schemes should be submitted to the Malaysian Investment Development Authority (MIDA).

A comprehensive overview of available incentives is provided by the MIDA website: http://www.mida.gov.my/home/incentives-in-manufacturing-sector/posts.

Source: MIDA.

The decision to grant or continue the extension of incentives requires a rigorous monitoring and evaluation of the investment project (and investor behaviour, e.g. how risk averse is the investor?) and the associated incentive programme. It also requires an economic and social cost-benefit analysis, which is difficult but necessary. Such an analysis will determine the gains from the investment with and without incentives (based on net present value or the NPV method). As indicated above, the granting of incentives is often conditional on the compliance with certain performance requirements (implicit or explicit). In the absence of performance deliverables, the incentives may be discontinued. Hence, there is a strong link between incentives and performance requirements. This link is important in determining the criteria for granting such incentives (box 5.5).

[93] An investment tax allowance is a tax incentive offered to businesses to encourage capital investment in which they can deduct a specified percentage of capital costs, including depreciation, from taxable income. Different from investment credits which allows businesses to deduct investment costs directly from their tax liability. (Source: **http://www.businessdictionary.com/definition/investment-allowance.html#ixzz4BdSAsI7O**.)

Box 5.5. Criteria for granting investment incentives

While the granting of investment incentives is generally discouraged there are cases where such incentives may make a difference, in particular if they are linked to certain performance requirements. In that case, the most straightforward criteria for granting such incentives are based on capital investment and employment creation, which can be measured accurately. Quality criteria are preferred to quantity criteria. In other words, rather than linking incentives to the number of jobs created, the quality of the jobs created should be taken into account. Incentives awarded should be the amount needed to attract the project (not the maximum available!). This is influenced by: (a) market size; (b) corporate tax rate; (c) what other locations are offering. The incentive awarded should always take into account what the net economic and social benefits of the project will be.

A proper incentive solution should lead to the following situations:

(a) Maximizes return on investment[94] through:
- Earlier revenue generation through accelerated start up;
- Optimization of benefits vs. costs;
- Maintained or improved quality/service levels.

(b) Investment generates positive externalities (OECD, 2003; James, 2009, 2013):
- R&D capabilities;
- Encouraging green technologies;
- Upgrading labour skills;
- Contribute to development in underdeveloped regions;
- Infrastructure projects that generate business and economic growth;
- Anchor investment[95] and establish backward linkages;

(c) Achieves ‘best deal’ with:
- Financial grants and incentives;
- Efficient VAT;
- Transparent taxation and transfer pricing issues;

(d) Provides an objective decision process:
- Independent and transparent;
- Based on “Best Practices”;
- Subject to careful monitoring and evaluation process but involving minimum use of resources and time to administer and monitor.

Source: ICA (2013); James (2009, 2013).

3. Monitoring and evaluation of incentive policies

The best way to find out whether incentives actually have their desired effect requires a careful monitoring and evaluation (M&E) exercise which is part of the incentive administration system (figure 5.2).

Any incentives policy must be designed in concert with a system for monitoring the application of the policy for two reasons:

(a) Avoidance of fraud and corruption: The system must protect against fraudulent acts by investors and beneficiaries and collect sufficient data to enforce an adequate checks and balances system to reduce, if not eliminate, corrupt behaviour by officials responsible for managing the system.

(b) Evaluation of effectiveness: Policy makers must have current and detailed information that will permit them to assess whether incentives are working as promised and to evaluate any necessary changes in existing policies.

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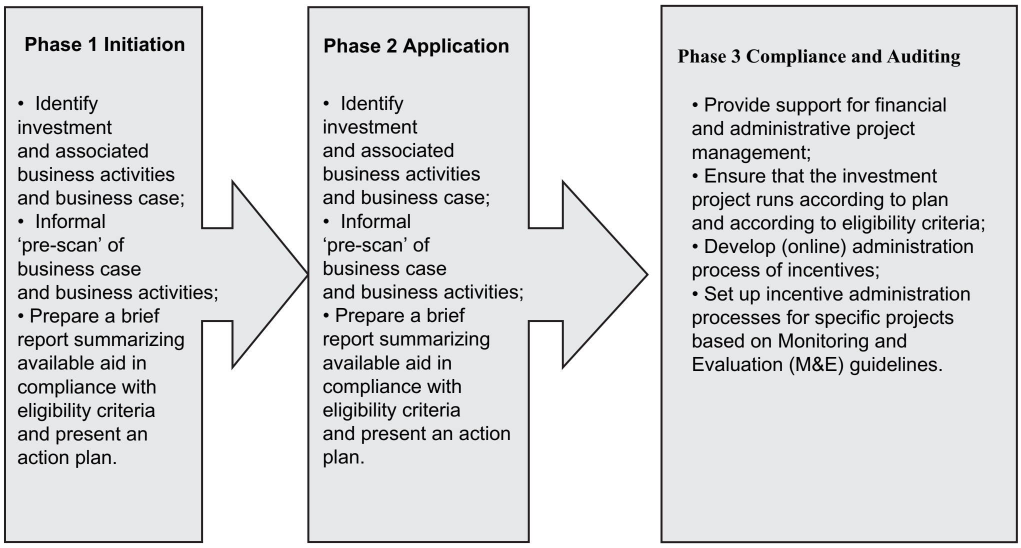
94 One could argue whether incentives should optimize return on investment. Instead, they should address market failures that might lead to a return on investment that is so low that the investment would no longer move forward.

95 Anchor investment refers to original/first investment that triggers confidence in other investors to follow suit.

Figure 5.2. Stages of incentive administration



Source: Investment Consulting Associates.

In fact, any M&E process of incentivized investments should be part of a country's IPA aftercare strategy in collaboration with the ministries responsible for awarding incentives. However, not many countries have established transparent and effective compliance mechanisms for their incentive programmes. Many investment incentives are awarded without any post-hoc evaluation of their results or promised economic objectives by companies. This can lead to a massive waste of public resources while neglecting deserving investment projects.

The following M&E techniques can be used:

- **Pre-assessments;**
- **Pre-implementation models;**
- **Surveys;**
- **Scoring models;**
- **Cost-benefit analysis (CBA).**

Pre-assessments (of investors) reduces the risk of granting incentives that a company does not necessarily need and the risk of paying overly generous incentives. This approach also permits greater targeting of incentives to specific kinds of business activities that correspond most closely to governments' development objectives. However, administering such a detailed scheme and ensuring uniformity and accountability in the criteria applied, the decisions made and the proper use of funds allocated, requires considerable administrative and financial capacities. Box 5.6 shows an illustrative list of key questions used in Ireland to assess investment projects before recommending financial incentives.

Pre-implementation models pre-assess the impact of incentives (i.e. the expected benefits from the investment) and are mostly executed in a quantitative manner through awarding points to a set range of criteria. However, such techniques are rare. The vast majority of incentive regimes do not evaluate the estimated impact of incentives but rather evaluates the actually achieved impacts (post-implementation). Such systems are virtually always part of the eligibility phase of an investment project when potential beneficiaries are required to achieve a certain minimum score to be qualified as "eligible" for incentives. Pre-implementation models often take policy objectives into account.

Surveys (of beneficiaries) are a useful mechanism to evaluate if, and to what extent, an incentive programme is effective and is in compliance with the initial eligibility criteria and contributes to a country's economic development goals. A survey or questionnaire is one technique that can be used to collect the primary data. With modern day IT infrastructure, it is relatively easy to develop an online version which enhances uniformity and transparency.

Box 5.6. Key questions to assess investment projects for incentives: Enterprise Ireland

Enterprise Ireland is the government organization responsible for the development and growth of Irish enterprises in world markets. They work in partnership with Irish enterprises to help them start, grow, innovate and win export sales in global markets. Among their clients are also Ireland-based food and natural resource companies that are overseas-owned or controlled. The criteria that Enterprise Ireland uses to assess companies for financial assistance are therefore useful benchmarks for assessing foreign invested companies as well.

(1) What are the needs of the company, as identified by the joint assessment of business development needs?

(2) Is the proposed development commercially viable?

(3) Is there a demonstrated need for State financial assistance?

(4) Is there a fair sharing of risk and reward between the company and Enterprise Ireland?

(5) How well does it fit with Enterprise Ireland's objectives?

(6) How exactly is the Irish economy going to benefit from this investment?

(7) Is the project helping to achieve broad objectives, such as:

   (a) a high-growth start-up;

   (b) a first-time exporter;

   (c) a high research and development performer;

   (d) a company with a new overseas presence;

   (e) a company with strong human resource development capability;

   (f) an e-Business company;

   (g) a company contributing to regional development?

Source: ICA (2013); Enterprise Ireland. Available from **https://enterprise-ireland.com/en**.

Such surveys should incorporate all important economic growth elements (e.g. job creation, capital investment, training, international trade and local dividends). The survey results should be validated with an (at least) annual company visit by a relevant official (e.g. an investment promotion officer) of the relevant Ministry or IPA. Given the type of information needed, sending this questionnaire to the beneficiaries every six months would be an appropriate frequency. The risk of course is that the feedback may not be accurate as investors would not undermine their access to incentives and therefore may have a tendency to report that the incentives are indeed very useful even when they do not need them. However, surveys may lead to corrections or changes in the incentive system to make incentives more efficient and effective (at least from the beneficiary point of view).

Scoring models constitute a scoring mechanism (pre- and post-implementation) to assess whether specific investments are eligible for incentives and are a commonly applied technique. Scoring mechanisms can also be used to monitor the progress of an incentivized investment. Based on a scoring mechanism it can be decided to grant a full or partial amount of financial support or invoke claw-back provisions.

Cost-benefit analysis (CBA) is very useful but complex as it is difficult to precisely assess the impact of the incentive framework in terms of (both direct and indirect) costs and benefits. The main question relates to "would a (foreign) investment project have located in a particular country if that country had eliminated its incentives while other countries with whom it competes maintained their incentives at existing levels?" Answering this question requires a good understanding of the role of incentives in corporate investment decisions and building specific alternative scenarios.

Essentially, a CBA takes into account the (capital) flows from and to the incentivized investments and accompanied by the opportunity costs of the incentive regime. The opportunity costs reflect the alternative options based on an assumed outcome without the incentive regime. The difference between the assumed "what if" situation with the actual current incentive situation results in marginal benefits and costs, and as such, an accurate analysis of the impact of incentives. The CBA should address both economic and social (and possibly environmental) costs and benefits (box 5.7). Costs may also be direct and indirect.

Expected benefits could be:

- The direct wages paid to local labour (market wage rate);
- The local purchases of public utilities and locally purchased inputs;
- Tax payments;
- Net profit income that flows to local equity shareholders;
- Indirect benefits through spillovers and multiplier effects.

Expected costs could be:

- Opportunity cost of wage or shadow wage rate;
- Opportunity cost of public utilities and locally purchased inputs;
- Capital infrastructure costs of the establishments of special economic zones and other related infrastructure;
- Taxes foregone;[96]
- Indirect cost of administration the incentives (for governments) and application for incentives (for investors);
- Indirect cost of time and money spent by business lobbying for incentives.

An accurate CBA is very challenging for various reasons. In particular, the costs and benefits may be felt by different stakeholders, can vary over time, and can depend on a range of factors such as the incentive tool being used. A particular challenge relates to the identification of metrics to calculate all involved direct and indirect costs and benefits and associated data collection (for more details see e.g. Johnson and others, 2013; Chen, 2015).[97]

Box 5.7. Elements of social cost-benefit analysis of tax incentives for FDI

Investment tax incentives ultimately aim to contribute to a country's development and improved living conditions for its citizens. The following elements are critical for the social benefits:

- **Size of the net investment effect**: the rise in investment should be corrected for redundancy effects (investments that would have occurred without the incentive) and displacement effects (the reduction in any other investments) to infer the net incremental increase in capital due to the incentive.
- **Net impact of higher investment on jobs and wages**. New jobs can yield significant social gains if they reduce unemployment. However, if new jobs displace existing jobs, the social benefits depend on the productivity (and wage) differential between the new and old jobs.
- **Productivity spillovers**. To the extent that new investment boosts productivity elsewhere in the domestic economy, such as in supplying or competing firms (often seen as a particular benefit from inward FDI), this magnifies social benefits by raising income levels more widely.

The social costs of tax incentives depend on the following factors:

- **Net public revenue losses**: public revenue falls if tax incentives are redundant or create leakage and abuse. But additional net investment and jobs can recover some of the revenue loss.
- **Administrative and compliance costs**, which can rise due to tax incentives, especially if they are complex or create opportunities for rent seeking and corruption.
- **Scarcity of public funds**. Often overlooked is that $1 of tax revenue has a higher social value than $1 of private income, because it is the greater value of the public expenditure it finances that justifies transferring resources from public to private sectors through distortionary taxes. To compare changes in private income and tax revenue, the latter thus need to be weighted by the 'marginal cost of public funds', which will be greater than unity.
- **Distorted resource allocation**. Discrimination in favour of some and against other investment implies that taxes, rather than productivity differences, determine resource allocation. This distortion reduces average productivity and lowers income per capita.

Source: IMF and others (2015); box 1.

[96] A proper way to calculate tax revenue foregone is a tax expenditure review. A tax expenditure review quantifies the revenue forgone for each provision, including for investment tax incentives. See IMF, and others (2015) for more details.

[97] See also: **https://www.smartincentives.org/blogs/blog/144025031-how-to-collect-data-to-determine-if-incentives-are-working**.

4. Recommendations for good incentive policies

Many countries are progressing fast with the development of a dynamic and innovative economy by offering a politically and economically stable and investor-friendly business climate. In theory, this should provide sufficient incentive for companies to invest in those countries and many do. However, incentives could tilt an investor decision in favour of a particular location with everything else equal.

Generally, when applied appropriately, incentives can create partnerships which benefit both community and company, address short-term hurdles, fix small regulatory and tax problems, create a sense of a community's willingness to work with business, promote sustainability, and tip the location decision in favour of the location granting the most attractive incentives. However, they cannot turn a bad location into a good one and compensate for a competitive weakness, address gross disconnects between location and business needs, create an industry cluster where it doesn't already want to exist, and ensure a long-term connection between business and community.

In particular, the following points and recommendations should be considered in formulating an incentive programme:

- It is important to understand whether incentives should emphasize comparative advantages of countries or compensate for the lack of these comparative advantages. If it is the second, they will probably fail.
- Incentives are, in most cases, not the key driver of an investment location decision by a company. Depending upon the industry and type of business activities, companies explore multiple location drivers or factors before they take a final decision on where to invest.
- The public administration of any incentive framework often requires more resources in terms of administration, monitoring and evaluation. Investment incentives should be affordable and lead to benefits exceeding costs (OECD, 2003).
- The use of fiscal incentives in designing an attractive investment environment ought to be limited and precisely targeted, consistent with evidence that their role in attracting or retaining investment is subsidiary to other more substantive factors which influence investment decisions, primarily market/business factors (labour supply, raw materials etc.) and investment infrastructure/environment (risk to investment assets, dispute resolution etc.).
- Any fiscal investment incentive needs to be transparent (box 5.8) and well-designed, i.e. clear, simple and certain, and preferably performance based against pre-determined criteria. Tax incentives should be part and parcel of the tax code and be extended on the basis of clear criteria rather than on an ad-hoc basis (IMF and others, 2015).
- Tax holidays may lead to transfer pricing or transfer or tax revenue from the host country to the home country of the investor and are the least preferred form of incentive. Tax holidays are also often ineffective for start-ups as often no income is generated in the start-up period when the tax holiday is applied anyway. Instead, it is better to use investment tax credits, investment allowances[98] and accelerated depreciation (James, 2009, 2013).
- Tax incentives that lower the cost of investment are often to be preferred over profit-based tax incentives (IMF and others, 2015).[99]
- Full costing and reporting of fiscal incentives should be undertaken annually, with an analysis of the cost of the fiscal incentive relative to the benefits arising from the investment (such as employment, exports, skill/capacity enhancement).

[98] Investment tax credit refers to deducting a fixed percentage of an investment from tax liability. Investment allowance refers to deducting a fixed percentage of an investment from taxable profit (in addition to depreciation). The value of the allowance is the product of the allowance and the tax rate (James, 2009).

[99] Cost-based tax incentives involve specific allowances linked to investment expenses, such as accelerated depreciation schemes and special tax deductions and credits. They are targeted at lowering the cost of capital and so make a greater number of investment projects more profitable at the margin – that is, may generate investments that would not otherwise have been made. Profit-based tax incentives generally reduce the tax rate applicable to taxable income; examples include tax holidays, preferential tax rates or income exemptions. One effect is thus to forego government revenue in order to make even more profitable investment projects that would be profitable, and hence undertaken, even without the incentive (IMF and others, 2015).

- Incentives for sustainable investment should not be stand-alone, but be one part of a publicly stated, wider government policy to promote and support sustainable development. Without (for example) an environmental protection law, or a sufficiently capable environmental protection agency, incentives to promote sustainable development will produce less than optimum outcomes.
- The design and subsequent adoption of sustainable investment incentives should support the achievement of the clear policy target to which the government is committed. In particular, they should be research-based and flow from findings that sustainable investment will not take place, or the rate of investment will be seriously impeded, unless such incentives are in place.
- The design of sustainable investment incentives should be driven by – and tailored to – the achievement of policy outcomes (perhaps in certain country-specific sectors) that the government is committed to realizing, and it should not be assumed that every form of fiscal incentive is automatically necessary.
- Ideally, incentives should not discriminate by nationality and apply equally to domestic and foreign investors in any given sector in order to avoid distortion of the business environment.
- The application and administration processes should be as simple and as concise as possible – avoid bureaucratic overload whilst maintaining sufficient rigour in the process.
- Integration of new incentives in existing incentive regimes – especially where there are multi-levels of government – is crucial to avoid unintended consequences.
- Creating awareness of and providing timely and accurate information on sustainable investment incentives is crucial for their uptake as is the capacity of relevant monitoring/administrative/regulatory agencies.
- As more and more countries seek to boost investment and target specific types of investment, the risk of harmful competition for investment increases; i.e. a race to the regulatory bottom or a race to the top of incentives (with negative social and environmental consequences or escalating commitments of public funds). Therefore, countries should strive to harmonize their tax and incentive policies, including agreeing on a list of prohibited tax incentives and limits to incentive schemes (in terms of size and time (James, 2009, 2013).
- Develop capacity of IPAs to do proper monitoring and evaluation of incentives.
- Incentives should have a fixed duration to allow for regular evaluation of incentive programmes assessing their relevance and benefits.
- Incentives should be linked to concrete sustainable development targets and conditions, especially regarding social and environmental targets and conditions.

Box 5.8. Principles of transparency of tax incentives

- Make public a statement of fiscal policy objectives outlining policies of the government in the medium term and the short term relating to taxation, expenditure, market borrowing and other liabilities, lending and investments and the key fiscal measures.
- Consolidate all the tax incentives that are provided either through the tax laws or otherwise.
- Calculate the amount of revenue losses attributable to tax incentives, in a yearly Statement of Tax Expenditures.
- The Statement of Tax Expenditure should include the largest beneficiaries of the tax incentives by individual taxpayer, sector, by specific tax provision and other criteria as required.
- The government should grant tax incentives in accordance with a comprehensive policy on tax incentives, which shall laydown principles and policies for the introduction or continuation of a tax incentive.
- The government should carry out a periodic review of the continuance of existing tax incentives by assessing the extent to which the tax incentives could meet the stated objectives.
- Tax incentives may be provided only through laws ratified through the law-making body or Parliament.
- Tax incentives once provided need to be administered in a transparent manner.
- The government should set up a mechanism for periodic data collection, which shall be used to prepare the Statement of Tax Expenditure.
- Governments should make commitments through regional agreements to avoid harmful tax competition.

Source: Sebastian James, Available from **http://www.imf.org/external/np/seminars/eng/2014/caribbean/pdf/S2p2-James.pdf**.

- Incentives should be in conformity with a country's international legal obligations as contained in the country's membership of IIAs, RTAs and WTO agreements, in particular the Agreement on Subsidies and Countervailing Measures and the TRIMS Agreement.

OECD (2003) developed a checklist of questions that guide policymakers in making prudent decisions with regard to the use of investment incentives. The checklist contains a set of policy choices and present operational criteria against which the relevance, quality and coherence of a policy framework can be assessed. The criteria fall into six broad categories, namely (a) the desirability and appropriateness of offering FDI incentives; (b) frameworks for policy design and implementation; (c) the appropriateness of the choice of strategies and policy tools; (d) the design and management of individual programmes; (e) transparency of procedures (i.e. evaluation, monitoring and follow-up); and (f) assessing the extra-jurisdictional consequences of FDI incentive strategies. Subsequently, OECD integrated the policy choices regarding incentives in its Policy Framework for Investment (PFI) of which the 2015 edition is the latest. The core questions of the PFI regarding incentives are contained in box 5.9. For a full list of questions and supplementary questions, reference is made to: **http://www.oecd.org/daf/inv/investment-policy/Policy-Framework-for-Investment-2015-CMIN2015-5.pdf** (pages 61-63).

Box 5.9. OECD PFI core questions on the use of tax incentives for investment

1. How does the government's tax policy support its development objectives and its investment attraction strategy?
2. Given the socio-economic and political conditions of the country, is it reasonable to assume that policy, including tax incentives can favourably affect investment decisions?
3. Where tax incentives are targeted to special groups/locations, can a non-uniform treatment of investors be justified?
4. Does appraisal of costs and benefits of tax incentives regularly take place to support government decision-making?
5. Are tax incentives consolidated in the tax law? Are they offered on an automatic or discretionary basis? Is the process for granting and administering tax incentives clear and transparent?
6. Have unintended domestic and cross-border tax-planning opportunities been evaluated? Have measures been taken to improve international tax co-operation to counter abusive tax planning strategies?

Source: OECD Policy Framework for Investment 2015.

C. SPECIAL ECONOMIC ZONES

1. Definition, rationale and purpose of special economic zones

Special economic zones (SEZs) take on many different forms but share some common characteristics. SEZs can be defined as:

> "demarcated geographic areas contained within a country's national boundaries where the rules of business are different from those that prevail in the national territory" (FIAS, 2008; Farole, 2011).

The different rules principally deal with investment conditions, international trade and customs duties, taxation, and the regulatory framework, including incentives not available outside the zone. In particular, the rules and regulations prevailing in SEZs are more liberal than in the rest of the country. However, there is no uniform definition and different countries use different definitions. Common characteristics include a demarcated area with special (more liberal) regulatory frameworks with a specialized decentralized governance structure and containing more developed infrastructural facilities.

In practice, the category 'SEZ' covers a broad range of more specific zone types, including Free Trade Zones (FTZ), Export Processing Zones (EPZ), Free Zones (FZ), Industrial Estates (IE), Free Ports, Urban Enterprise Zones and others. There are many variations on the theme. Free trade zones around the world are called by a number of different names, depending on the country in which they are located and the particular type of zone. In the United States, they are referred to as foreign-trade zones. Those in developing countries producing

specifically for export are typically called export processing zones. They are also called special economic zones in China, industrial free zones or export free zones in Ireland, Qualifying Industrial Zones (QIZs) in Jordan and Egypt, free zones in the United Arab Emirates, maquiladoras in Mexico, duty free export processing zones or free export zones in the Republic of Korea, export processing zones in the Philippines, investment promotion zones in Sri Lanka and foreign trade zones in India (Creskoff and Walkenhorst, 2009). Free trade zones are a specific type of restricted access (e.g., fenced-in) industrial park housing concentrations of production facilities and related infrastructure. They are typically located at or near sea, air, or land ports. Free trade zones (FTZs) have become a substantial part of the structure underpinning the global supply chain. UNIDO (2015) refers to the more generic term "economic zones" comprising of industrial parks, special economic zones, eco-industrial parks, technology parks and innovation districts. Chen (2009) uses the term "free economic zone" and points out that such zones can also be cross-border cross-national and include international growth zones and growth triangles. However, at the other extreme a single SEZ can contain multiple "specific" zones within its boundaries. The most prominent examples of this layered approach are Subic Bay Freeport Zone in the Philippines, the Aqaba Special Economic Zone Authority in Jordan, Sri City Multi-product SEZ and Mundra SEZ in India.[100]

SEZs are set up for various purposes, often to experiment with economic reform, create employment, and provide infrastructure in a smaller area. SEZs are often set up as a pilot project for wider economic reform and almost always involve the attraction of FDI (FIAS, 2008) though in many cases SEZs are open to domestic companies (suppliers) also.

SEZs have played an important role in the expansion of GVCs. While rules differ among individual countries, zones typically operate outside the country's boundaries for customs purposes even though they are geographically located inside the country. As a result, the supply chain of products may be scattered among zones all over the world without concern for tariffs, quotas, and detailed customs procedures, until they finally exit the zone system in the country where the final product is produced. At that time only they are subject to tariffs, quotas and full customs procedures (Bolle and Williams, 2013). Box 5.10 provides some examples of how SEZs work within the context of GVCs.

Box 5.10. Some examples of how the world zone network functions

"Suppose buttons from Indonesia and fabric from India are sent to a trade zone in the Philippines for assembly into a shirt which is then exported to the United States. No tariffs are payable in the Philippines, and all customs procedures are streamlined until the completed shirt enters the United States for consumption. If, when shipped to the United States, the shirt first enters a U.S. FTZ, taxes and tariffs are only payable if the shirt is eventually imported for consumption—that is, when it exits the FTZ into the customs territory of the United States. It might enter an FTZ for purposes of cost savings, for example, if more work is required (e.g., laundry labels); if some of the shirts were damaged in shipment and will be discarded; or if a company wants to store them for later use (e.g., Christmas sales) and postpone tariff payment.

Similarly, imported crude oil is entered into a refinery for the production of gasoline and the refinery has applied for and received status as an FTZ subzone (i.e. a site approved for a specific company or use). The tariff structure on refined oil products varies, such that some, for instance gasoline, have much higher tariffs than crude oil, while others, including certain petrochemicals, have a zero tariff, and hence an inverted tariff structure exists. If the refined products exit the zone and are imported into United States customs territory, the company can choose to pay tariffs on the crude oil that initially entered the zone or the tariffs (if any) on the refined goods. In addition, chemicals distilled from the crude may stay in the zone or be transferred to a chemical manufacturing facility which is in a nearby subzone for further refining. In the refinery process, as in other production processes in FTZs, tariffs are not payable on any waste products."

Source: Bolle and Williams (2013), box 2.

Bolle and Williams (2013) provide a useful description of free trade zones and note that such zones around the world are similar in the way they function to facilitate trade but differ in terms of size, economic development purposes, physical characteristics, government incentives, and the final dispensation of their products: "They may represent large shares of the country's manufacturing employment and occupy huge geographic areas, as in China; or they may be small enclaves housing a few businesses. In developing countries with little

[100] Mention of the information contained in this paragraph is made in various publications and online websites, e.g**. http://sezinindia.com/sez-globally**.

infrastructure, they may be self-sufficient city-like industrial complexes with housing, restaurants and banking, as well as production and/or transport facilities. In developed countries, that have extensive infrastructure and modern facilities, they are more narrowly limited to providing production and/or transport facilities. [...]. All zones typically include streamlined customs procedures and exemption or deferral of tariffs and quotas on stored inventories. Those in developing countries are more likely to have additional incentives such as subsidies, more flexible labour market regulations, and additional tax exemptions. While developing countries typically produce for export, they increasingly consume ("import") substantial shares of products made in their free trade zones as they develop."

Following the Chinese success, SEZs have been established with various success rates in several countries, including Bangladesh, Brazil, Cambodia, India, Islamic Republic of Iran, Jordan, Kazakhstan, Pakistan, the Philippines, Poland, Republic of Korea, Russian Federation, Ukraine, United Arab Emirates, Cambodia, and the Democratic People's Republic of Korea.

In this handbook, for the purpose of attracting FDI the focus is on two specific forms of zones at the national level: (1) the EPZ or free zone, which focuses on manufacturing for export (see box 5.11 for the experience of Bangladesh); and (2) the large-scale SEZ, which usually combines residential and multi-use commercial and industrial activity (Farole and Akinci, 2011). The former represents a traditional model which has been used widely throughout the developing world for almost four decades. The latter represents a more recent form of economic zone, originating in the 1980s in China and gaining in popularity in recent years (see boxes 5.12. and 5.13 for the experiences of China and India with SEZs).

Box 5.11. EPZs in Bangladesh

Bangladesh was among the first countries in Asia-Pacific to embrace the EPZ concept with the promulgation of the BEPZA Act 1980 which led to the establishment of the Bangladesh Export Processing Zones Authority (BEPZA), the government agency responsible for creation, operation and development of EPZs in the country. The first EPZ was set up in Chittagong in 1983, followed by the first EPZ in Dhaka in 1991. The purpose of EPZs was the attraction of FDI for export purposes. BEPZA effectively acts as an investment promotion agency for EPZs. Currently, there are eight EPZs with investment from close to 40 countries. Leading investor countries are China, Japan and the Republic of Korea. Manufacturing industries were the original target but the BEPZA is currently targeting investment in utilities also. The EPZs are open to foreign investors, joint ventures and Bangladesh owned companies. Close to 60% of enterprises operating in the EPZs are foreign-owned.

BEPZA provides infrastructure facilities for investors including fully serviced plots with utilities under a 30-year lease. It acts as a one-stop shop for project approvals, work permits, import and export permits (issued within one day), customs clearance at the factory site, and aftercare services. Most of the EPZs focus on textiles and garments, electronics and electrical products, chemicals, software, agro-processing, toys, and other labour-intensive manufacturing industries. Incentives include a tax holiday of two years, with a 50% tax exemption in the third and fourth year of operation, and 25% tax exemption in the fifth year. Investors also enjoy duty free imports of raw materials, machinery, equipment, and construction materials. Some EPZs have a seven-year tax holiday.

According to BEPZA's latest available Annual Report (May 2015), the eight EPZs have contributed to an accumulated investment of $3.5 billion, attracted 432 industries creating jobs for almost 420,000 workers and generating exports worth $44 billion, about 19% of total exports. Two-thirds of workers are women.

BEPZA is government-owned and operated. In order to enhance sustainability, the Government raised the minimum wage to $70 per month. It also passed the 2010 EPZ Workers Welfare Association and Industrial Relations Act to ensure the rights and welfare of EPZ workers. Social and environmental inspectors ensure full compliance with social and environmental regulations and standards. In order to enhance environmental sustainability, BEPZA set up hi-tech eco-friendly service oriented industries including power plants, central effluent treatment plants and water treatment plants.

The Foreign Private Investment (Promotional and Protection) Act of 1980 secures all FDI against expropriation, nationalization, and ensures fair and equitable treatment and free repatriation of profits.

Bangladesh's EPZs became only successful after the Government switched focus from high-technology industry to promoting the labour-intensive garment sector in which the country had a clear comparative advantage (Farole and Akinci, 2011).

Source: BEPZA (**http://epzbangladesh.org.bd/pages**; **http://bdembassyuae.org/pdf/EPZ%20in%20Bangladesh%20-%20An%20Attractive%20Investment%20Destination.pdf**).

Box 5.12. SEZs in China

Special economic zones were pioneered and introduced by China under Deng Xiaoping in the early 1980s. The most famous SEZ, Shenzhen, has evolved from a small fishing village into a city of over 10 million people within the time span of just 20 years. Since 1988, China's opening to the outside world has been extended to its border areas, areas along the Yangtze River and inland areas. The Shenzhen SEZ was followed by SEZs in Guangdong and Fujian Province: Shantou, Xiamen, and Zhuhai and a number of cities, including Shanghai (Pudong) and Hainan Island. The latest SEZ proposal is in Kashgar in Xinjiang Province in China's far west. In addition, a large number of free trade zones, state-level economic and technological development zones, and new and high-tech industrial development zones have been established in large and medium-sized cities. SEZs are foreign trade-oriented areas which integrate science, innovation and industry with trade. Foreign firms benefit from preferential policies such as lower tax rates, reduced regulations, private property rights protection; the right to use, transfer or lease land rights; and special managerial systems.

In China, SEZ programmes on average have increased the level of per capita FDI by 21.7% and the growth rate of FDI inflows by 6.9 percentage points. (Wang, 2013). During the 1980s-1990s over 70% of FDI was flowing to provinces with SEZs or SEZ-like zones. The zones have been extremely successful in attracting FDI and there is a clear positive relationship between FDI inflows and SEZ expansion. (McCallum, 2011).

What makes the SEZ programme in China unique is its decentralized management structure. An administrative committee, commonly selected by the local government, oversees the economic and social management of the zone, including approving the FDI projects up to a certain limit, building and improving the infrastructure, and regulating the land use on behalf of the local administration. The World Bank has described China's SEZs as a unique zone-within-zone case because large opened economic zones (the whole municipality) hosted smaller zones (state-level and province-level economic zones) within their territory.

Economic characteristics are represented as "4 principles": (1) Construction primarily relies on attracting and utilizing foreign capital; (2) Investing enterprises consist of joint ventures between Chinese and foreign companies and wholly foreign-owned enterprises; (3) Products are primarily export-oriented; (4) Economic activities are primarily driven by market forces. China's primary purpose of establishing SEZs was to experiment with market forces while maintaining a level of state control in conformity with its communist ideology. For that purpose, SEZs gained unparalleled freedoms. For instance, Shenzhen was exempted from the requirement of submitting tax revenues to the central and provincial governments over its first 10 years, an advantage that allowed it to experiment with whatever policies and practices it deemed expedient to vitalize the economy. In Shenzhen, more than $30 billion in foreign investment has gone into both foreign-owned and joint ventures, at first mainly in manufacturing but more recently in the service industries as well. Shenzhen started with a focus on textiles and garments and evolved as the leading city in China for telecommunications and electronics manufacturing. It is currently a hub for Electronic Manufacturing Suppliers (EMS) and Original Equipment Manufacturers (OEM).

Shenzhen's objective was "learning by doing," and creating forward and backward linkages with a multitude of local suppliers. As of 1998, high-tech industries accounted for almost 40% of the industrial output within Shenzhen SEZ. In 2008, Shenzhen registered more patents than any other city in China, with 2,480 new patents. Between 1978 and 2014, Shenzhen's GDP per capita grew by almost 25% from RMB 606 to RMB 149,500 (around $24,000). The population in turn grew from a mere 30,000 to a world city of more than 10 million inhabitants (UNIDO, 2015). China's new Labour Contract Law implemented in 2008 extended to cover all workers including urban workers as well as rural migrant workers, it also offers improved legal protection and job security to workers and it requires employers to consult with trade unions and workers' representatives. (McCallum, 2011).

In conclusion, the economic impact of the Shenzhen SEZ has been overwhelmingly positive prompting the Government to introduce market forces country wide. Wang (2013) found that the SEZs had contributed to inflows of FDI, increases in total factor productivity, technology transfer and higher wages for workers in SEZs. He also found that SEZs neither crowd out nor crowd in domestic investment. However, Gopalakrishnan (2007) found negative impacts of SEZs and argues that only the Shenzhen SEZ could be considered a success. Among the negative aspects, he mentions speculative markets in land use rights and real estate, labour abuse and child labour, distress migration, and crime.

Sources: Wang (2013), online resources and references mentioned in the text.

The institutional arrangement for SEZs typically involves a developer (investor), operator, and regulator (zone authority) and owner (government or private sector). The institutional structure can vary from fully public (government operator, government developer, government regulator) to fully private (private operator, private developer, public regulator). In many cases, public sector operators and developers act as quasi-government agencies in that they have a pseudo-corporate institutional structure and have budgetary autonomy. SEZs are

often developed under a public-private partnership arrangement, in which the public sector provides some level of support (provision of off-site infrastructure, equity investment, soft loans, bond issues, etc.) to enable a private sector developer to obtain a reasonable rate of return on the project (typically 10-20% depending on risk levels).[101]

FIAS (2008) notes that the majority of SEZs in developing and transitional economies are private sector developed and operated. It lists the following models for public-private partnerships:

- Public provision of off-site infrastructure and facilities (utilities connections, roads) as an incentive for private funding of on-site infrastructure and facilities.
- Assembly of land parcels with secure title and development rights by the government for lease to private zone development groups, development of better land use/ownership laws and regulations and adoption of enforceable zoning and land use plans.
- Build-operate-transfer and build-own-operate approaches to on-site and off-site zone infrastructure and facilities, with government guarantees and/or financial support.
- Contracting private management for government-owned zones or lease of government zone assets by a private operator (beneficial ownership).
- Equity-shifting arrangements whereby a private contract manager of a government zone can exercise a purchase option once pre-defined performance levels have been reached.

2. Have special economic zones been successful?

Experiences with SEZs have demonstrated that they have been relatively successful in terms of economic impact depending on their specific purpose in some countries but not in others. Empirical studies tend to focus on the economic impact of government-run zones rather than private sector run zones. Studies that have focused on the social and environmental impact of SEZs usually found a negative impact, but failed to address the economic impacts which may have been positive (FIAS, 2008). Studies have also generally failed to compare the impact of incentives in SEZs compared to the impact of incentives in sectors operating outside the zones. In any case, in order to assess impact there is a need to define what constitutes zone benefits and costs. FIAS (2008) and Farole and Akinci (2011) distinguish both static and dynamic economic benefits:

- Direct employment creation and income generation;
- Export growth and export diversification;
- Foreign exchange earnings;
- FDI attraction (and the benefits of FDI);
- Contribution to government revenues.

The dynamic benefits are long-term and much harder to measure, but are potentially far more important and are directly linked to the expected benefits of FDI and include:

- Indirect employment creation (including through backward linkages between TNCs and domestic companies which are located either inside or outside the zone);
- Skills upgrading;
- Female employment;
- Technology transfer;
- “Demonstration effect” arising from the application of “best practices”.

FIAS (2008) further notes that regional development zone development also entails a range of financial and economic costs, including salaries of government workers in the zone authority and other operating expenses; infrastructure development outlays; import duties and charges lost; and taxes foregone from firms relocating from the domestic customs territory to the zone. Clearly, the costs to government are higher for government-developed, operated and managed SEZs. The costs also tend to be higher for SEZs that have been developed without a proper cost-benefit analysis with reference to their selected location and stated purpose and SEZs that have been developed and operated by government entities and/or officials that do not have the required competence, skills or resources. With broad-based political commitments and a conducive policy environment SEZs have

[101] Available from **http://www.internationaldevelopmentgroup.com/practice-areas/public-private-partnerships-special-economic-zones**.

clearly had a positive impact on economic variables such as employment generation, exports and FDI as China's and Bangladesh's SEZs have demonstrated. However, these benefits have to be assessed against the costs, including social and environmental costs.

The costs of SEZs clearly go beyond economic costs only and include social and environmental costs. Many SEZs have been accused of undermining labour and environmental standards as incentives for foreign investors seeking pollution havens. Often, land grabbing has displaced farmers who have received little compensation (see box 5.13 for the case of India). SEZs often lead to negative impacts on the environment through unsustainable water use, air pollution and factory effluents. For instance, UNIDO (2015) reports that "although industrial parks in Viet Nam have positively contributed to Viet Nam's rapid economic transformation, they have also widely contributed to Viet Nam's environmental degradation. Around one-third of all industrial zones in Viet Nam don't have a centralized waste water treatment or sewage system. Additionally, industrial zones consume lots of energy due to inefficient production methods. Most companies in industrial zones have not adopted strict environmental standards and release toxic emissions such as dust, SO_2, NOx, GHG, UP-POP contributing to the air quality degradation." In order to fast track approvals for investors in SEZs, a proper environmental impact assessment is often done away with. FIAS (2008) comprehensively discusses the economic, social and environmental impacts of SEZs. In order to make SEZs contribute to sustainable development, these issues need to be addressed through a proper policy and regulatory package.

Box 5.13. Falling short of expectations: SEZs in India

India was one of the first countries in Asia to recognize the effectiveness of the EPZ model in promoting exports, with Asia's first EPZ set up in Kandla in 1965. This was followed by the Santa Cruz Electronics Export Processing Zone (SEEPZ) at Mumbai in 1974 and zones Noida, Madras, Cochin, Falta and Visakhapatnam. With a view to overcome the shortcomings experienced on account of the multiplicity of controls and clearances; absence of world-class infrastructure, and an unstable fiscal regime and with a view to attract larger foreign investments in India, the Special Economic Zones (SEZs) Policy was announced in April 2000. India passed the Special Economic Zone Act in 2005. After extensive consultations, the Act, supported by SEZ Rules, came into effect on 10 February 2006, providing for drastic simplification of procedures and for single window clearance on matters relating to central as well as state governments.

The Act offers a highly attractive fiscal incentive package, including exemption from custom duties, central excise duties, service tax, central sales taxes and securities transaction tax to both the developers and the units. Tax holidays for 15 years, i.e. 100% tax exemption for five years, 50% for the next five years, and 50% of the ploughed back export profits for the next five years; and 100% income tax exemption for 10 years in a block period of 15 years for SEZ developers. A Single Window SEZ approval mechanism has been provided through a 19-member inter-ministerial SEZ Board of Approvals (BoA).

Lal (2013) notes that the SEZs have attracted labour-intensive industries that have created employment and contributed to a rise in India's exports. "The benefits derived from the multiplier effect of the investments and additional economic activity in the SEZs and the employment generated thus will far outweigh the tax exemption and the losses on account of land acquisition." He further notes that "stability in fiscal concessions is absolutely essentially to ensure the credibility of Government intentions." Aggarwal (2007) notes that a majority of investments in SEZs have come from domestic sources. In 1989 the share of FDI in total investment was 12% increasing to 18% in 2000 and to about 25% towards the end of the decade.

However, generally speaking, studies evaluating the impact of SEZs in India, though not particularly recent, are not overwhelmingly positive. For instance, one study notes that the SEZ policy in India "has yielded only modest results in terms of exports, employment and investments. The socio-economic costs of human displacement and the socio-legal costs of land acquisition have been observed to far outweigh the benefits that have accrued from the policy."[102] Aggarwal (2007) notes positive impacts, in particular for female labour but also notes that the full potential of SEZs has not been reached. She also notes that in India, SEZs have attracted mostly medium tech activities that use similar technology as export orientated firms outside the zones. Therefore, there has been little opportunity for technology transfer. There are no recent available studies on the impact of SEZs, in particular on evaluating the impact of the rapid increase in SEZs after the adoption of the 2005 SEZ Act. However, widely noted negative economic impacts in the context of India includes revenue forgone from customs duties and the high costs of incentives compared to foreign exchange earnings and other financial benefits. Backward and forward linkages with domestic enterprises inside or outside the zones have largely been limited. Negative social impacts include land grabbing, loss of income and lack of

[102] Available from **http://shodhganga.inflibnet.ac.in/bitstream/10603/21109/8/11_chapter%202.pdf**.

adequate compensation of displaced farmers (Salil, 2007). Human rights violations are also noted by Nomani and Rauf (2012). Additionally, there are also cases where company management has colluded with local authorities in an effort to suppress the rights of the workers (Aggarwal, 2007).

SEZs units are exempt from environmental impact assessment to allow fast-track approval which may undermine the environmental sustainability of SEZs. The rationale is that SEZs are only permitted to contain "non-polluting" industries and facilities, which does not take into account the huge need for water of SEZs.[103] In addition, many SEZs in India were established in the IT sector, which were beneficial for IT specialists but not for displaced farmers and other unskilled workers. In other words, while SEZs have limited economic benefits (which may have accrued in a beneficial policy environment regardless of the existence of an SEZ), the negative social-environmental impact may outweigh the economic benefits.

The reasons for the relatively limited success of SEZs in India and other countries may lie in the lack of an overall conducive national policy environment, availability of required infrastructure outside the zones as well as flexible labour policies. SEZs may be enclaves (and in India of rather small size compared to those in China) but sooner or later they will have to establish linkages with the rest of the country in order to have broader benefits. As the rest of the country is insufficiently developed, SEZs may fail to deliver the expected benefits. SEZs can only be effective if investors are attracted by superior infrastructure, availability of required skills and proper management of zones, preferably by the private sector (in India most SEZs were managed by the Government though private sector managed SEZs rose sharply after the adoption of the 2005 SEZ Act). Forced local content rules are disincentives in the absence of qualified domestic enterprises. While companies in SEZs could benefit from a growing consumer base in India itself they incur full import duties when selling their products to the domestic market. Overgenerous incentives cannot compensate for the lack of an effective investment and business climate. It has also been observed that "as much as 75% of the SEZ area can be used for non-core activities, including the development of residential or commercial properties, shopping malls and hospitals. Developers will surely use this to make money via the real estate route rather through export promotion."[104]

Source: References quoted in text.

The empirical evidence of the actual impact is mixed and hampered by considerable statistical challenges. Farole and Akinci (2011) cite evidence of the successful contribution of SEZs to static economic benefits (in particular employment) in Bangladesh, China, Republic of Korea, Taiwan Province of China and Viet Nam but notes that the cheap labour advantage of SEZs is being eroded by more sophisticated determinants of FDI such as higher skills, technology and the need for better infrastructure in sectors other than labour-intensive industries (which are, in any case, subject to a high level of automation). In addition, as members of the WTO, countries may need to review the structure of export incentives and subsidies in order to make it compatible with the WTO regime (in particular the ban on specific subsidies which are contingent on export performance). Similarly, performance requirements may run afoul with the WTO Agreement on Trade-Related Investment Measures (TRIMS). This issue is further explained in box 5.14.

Box 5.14. Implications of WTO disciplines for incentives in SEZs in developing countries

Incentives related to special economic zones can be broadly grouped into three categories: (a) measures that are consistent with the WTO, notably exemptions from duties and taxes on goods exported from SEZs; (b) measures that are prohibited or subject to challenge under WTO law, notably export subsidies and import substitution or domestic content subsidies; and (c) measures where WTO consistency depends on the facts of the particular case. The single most important zone policy reform to achieve WTO compliance is to remove all requirements to export and permit importation of goods manufactured in SEZs into the national customs territory without any restrictions other than the application of import duties and taxes.

The Agreement on Subsidies and Countervailing Measures (SCM) distinguishes prohibited and actionable subsidies.

Prohibited subsidies are non-agricultural subsidies that are contingent on export performance, and subsidies that are contingent on the use of domestic goods in place of imported goods. Examples of prohibited export subsidies are:

[103] Ibid.

[104] Available from **https://neerajmishra.wordpress.com/2008/07/26/sez-special-economic-zone-an-overview-challenges-and-future**.

- Currency retention schemes which involve a bonus to exporters;
- Internal transport and freight charges on export shipments that are more favourable than for domestic shipments;
- Provision of goods and services for export manufacturing more favourable than domestically consumed goods;
- Exemptions or allowances for direct taxes or other charges to exports or for export performance;
- Exemption or remission of export taxes or indirect taxes in excess of those levied on products when sold for domestic consumption;
- Export credit guarantees or insurance at premium rates which are inadequate to cover the long-term operating costs and losses of the insurer;
- Export credit rates below the cost of funds.

Actionable subsidies are those that are granted by a WTO member country that have "adverse effects" on international trade, because they either cause injury to the domestic industry of another member country; nullify or impair WTO benefits; or cause "serious prejudice" to the interests of another member country.

The WTO disciplines are most relevant to middle income countries as LCDs and countries with GNP under $1,000 (1990 dollars) are exempt from the SCM Agreement. Measures that are taken by private SEZ operators are not subject to WTO disciplines.

Source: Creskoff and Walkenhorst (2009); FIAS (2008).

Aggarwal and others (2011) note that that the role SEZs have played in export performance and productive diversification in Bangladesh, India and Sri Lanka varied across sectors and products. In particular, they note that "some of the sectors in Bangladesh, India, and Sri Lanka in which substantial exports from SEZs can be observed were already outward-oriented before SEZs were set up." They do find evidence of the contribution of SEZs in these countries to product and export diversification and growth.

SEZs have been relatively successful in ASEAN countries, in particular in Malaysia and the Philippines. For instance, in 2012, Clark SEZ in the Philippines contributed to $4 billion export revenue and employment for 70,000 workers while economic zones in Viet Nam contribute to 40% of the country's total exports (UNIDO, 2015). A study on Malaysia's SEZs, which played an important role in boosting the country's production and exports of electronics, found that the EPZs have been a success when it comes to direct effects, but that the indirect effects are still relatively limited and concentrated to certain areas, such as Penang (Furby, 2005).

A UNIDO study (UNIDO, 2015) reports that there are more than 1,000 economic zones in ASEAN (most are industrial parks) including over 80 SEZs. The study also notes that ASEAN countries compete fiercely in attracting FDI in SEZs through generous incentives. It is difficult to measure the impact of SEZs in ASEAN as management structures and compilation of statistics differ widely among the individual countries. For instance, Malaysia and Indonesia have no government body in charge of economic zones, while Thailand and Viet Nam have government bodies, i.e. the Industrial Estate Authority of Thailand (IEAT) in Thailand and Department of Economic Zones at the Ministry of Planning and Investment in Viet Nam, respectively. These bodies are in charge of monitoring and promoting economic zones in their respective countries. SEZs also play an important role in the drive of Cambodia and Viet Nam to achieve middle income status through industrialization though there are serious social and environmental concerns as noted above. Myanmar is the latest country to jump on the SEZ bandwagon (see box 5.15 on Dawei SEZ).

Based on several decades of experience with SEZs, FIAS (2008) cites the most common obstacles to their success:

- poor site locations, entailing heavy capital expenditures;
- uncompetitive policies—reliance on tax holidays, rigid performance requirements, poor labour policies and practices;
- uncompetitive fiscal incentives;
- poor zone development practices—inappropriately designed or over-designed facilities, inadequate maintenance and promotion practices;
- subsidized rent and other services;

Box 5.15. Obstacles to SEZ development: the case of Dawei SEZ in Myanmar

The development of the Dawei SEZ in Myanmar's Tanintharyi Region started in 2008 under a memorandum of understanding between the Governments of Myanmar and Thailand. It was supposed to become ASEAN's largest SEZ/ industrial zone incorporating both foreign investors and domestic companies. The zone was supposed to be developed by the private sector, under a consortium consisting of Italian-Thai PLC in Thailand and Max Burma Conglomerate. However, Italian-Thai ran out of money and Max Burma withdrew from the project. This led to a delay in construction in 2013 and an audit by international auditing companies to verify that the zone was built to international standards. In the meantime, the Governments of Myanmar and Thailand took over the project and looked for international investors. Japan was invited to join as an investor but declined as the Government of Japan did not agree with the redevelopment plans. In the meantime, the project was supported by Thai banks. Japan finally agreed to join in January 2015. The Government of Thailand is once again engaging Italian-Thai as the private sector partner and provides soft loans to Myanmar. Rojana Industrial Park PLC is another private sector partner. Construction is still ongoing but it will be many years before the SEZ will be fully operational.

The development of the Dawei SEZ has encountered multiple problems, including cost overruns and lack of a solid development plan and feasibility study. The project was not considered financially sound from the beginning. However, the biggest criticism of the zone is based on the perceived lack of sustainability in particular as the rule of law in Myanmar does not yet meet international standards. The project has been charged with human rights violations, including forced evictions, land seizures, lack of adequate compensation, and denial of local communities' rights to sufficient food and adequate housing. There are also significant environmental and health concerns as the zone will be a major source of pollution.

The Dawei Project will be eight times larger than the Map Ta Phut Industrial Estate in Rayong province, Eastern Thailand. It will include a deep-sea port, a coal-fired power plant, petrochemical and other related industries, which are expected to cause massive pollution. The project also requires massive relocation of over 30,000 local people. The Dawei Development Association, a coalition of civil society groups, was set up by residents of Dawei to look into the project, and raise awareness. A report released in 2014 by the Tavoyan Women's Union, a local rights NGO in Dawei, claimed the project has undermined local agricultural and fishing livelihoods, through the confiscation of land, restriction of coastal access, and destruction of farmland. The report also found that villagers in Dawei were now facing food insecurity, and three-quarters of people surveyed reported that they had to take their children out of school for financial reasons.

There are also concerns that the location for the SEZ is not suitable given the remoteness, and lack of development and infrastructure of the region. The area is arid and sparsely populated and has not readily available labour supply. The zone is also located far away from established trade routes.

Sources: online resources including: **http://www.terraper.org/web/en/node/1012** (Bangkok Post, 16 October 2013); Sekine (2016): **http://www.burmalibrary.org/docs21/TNI-2016-02-04-Dawei_SEZ-Sekine-en-red.pdf**; **http://www.newmandala.org/myanmar-special-economic-zones-part-i**; **http://myanmarbusinessgateway.com/tags/dawei-sez.**

- cumbersome regulations and procedures and restrictive controls on zone activity;
- inadequate administrative structures or too many bodies involved in zone administration; weak administrative bodies;
- lack of coordination between private developers and governments in infrastructure provision.
- exclusion of merchandise processed in zones from entry under bilateral and regional trade agreements.

Some other reasons why SEZs have failed to increase economic development include poor strategic planning, corruption, lack of finance and mismatch of comparative advantages. (IFC, 2013) The failure to create an attractive investment environment has also been one of the factors (Farole, 2011).

There is a lack of systematic data-driven analysis on the performance of economic zones around the world which hampers evidence-based policymaking (Farole, 2011). In this regard, the opportunity costs of developing SEZs can be significant, i.e. could the resources be used for more socially-desirable policies instead, such as education and health? And to what extent are SEZs trying to compensate for the lack of nation-wide economic reforms? Another obstacle is the lack of a proper demand assessment. SEZ developments should be demand-driven and respond to market requirements which often require a feasibility study.

In the end, the experiences with SEZs have been mixed. There is ample evidence that they have been relatively successful in East Asia in terms of employment generation, technology transfer and industrial restructuring, mostly through the attraction of FDI. As FIAS (2008) notes:

"In Malaysia and the Philippines, there has been significant industrial upgrading in the electronics sector located mainly within zones (Lall, 2000). The Philippine Economic Zone Authority has documented the substantial rise in skill levels in the Philippine eco-zones, with decreases in the proportion of the production workforce in electronics industries in favour of more skill-intensive design and research activities. The software technology parks in India, for example, were critical to the expansion and upgrading of ICT activities, not just in terms of routine data entry and software coding operations, but also in much more complex software development, content development, and multimedia operations."

The next sub-section seeks to summarize the success factors for SEZs and policy recommendations for successful SEZ development, operation and management.

3. Success factors and policy recommendations for SEZ development, operation and management

Based on best practices and the available literature the following observations and recommendations regarding SEZs as a modality to attract FDI and stimulate economic growth can be made (e.g. Farole and Akinci, 2011; FIAS, 2008; Engman and others, 2007):

- As the global economy is changing and the United States and Europe are losing their position as the drivers of global demand, the establishment of traditional SEZs/EPZs focusing on assembly activities may not be as successful a strategy as in the past. Unless countries have significant labour cost advantages or can offer a large domestic market, they need more sophisticated strategies to attract investment.
- SEZs need to be competitive (see box 5.16) and prevent "enclave" syndrome. In particular, the focus of SEZs needs to shift from attracting labour-intensive to innovation-driven investment. The traditional concept of SEZs/EPZs is losing competitive relevance in the wake of global supply chain consolidation, weaknesses in traditional export markets, global regulation (WTO) and the loss of low labour costs as a competitive advantage. Higher value-added, technology- and service driven zones are more important (ICT, biotech, etc.).
- New SEZs should focus on wielding stronger physical, strategic and financial links with the local economy. The provision of excellent infrastructure, reliable power and skilled labour is much more important than incentives. SEZs should have a fully operational single window for all investment approvals and facilitation. Attractive on-site residential facilities (schools, shopping, R&R) should be available. In short, SEZs need to create a more attractive investment environment than in the rest of the country.
- SEZs should be located in strategic locations, i.e. close to population and urban centres with sophisticated infrastructure (ports, railroads, roads, etc.). SEZs could be developed as part of dry ports as well in inland areas.

Box 5.16. Incentives and development of border SEZs in Thailan

On the 20th April 2015, to promote Thailand as a hub of the ASEAN Economic Community (AEC), the Government of Thailand approved a draft Royal Decree for tax incentives (Incentives) to encourage investments in new SEZs.[105] The SEZs will be set up in two phases mostly in border areas in underdeveloped areas to promote cross-border trade in Tak, Sa Kaeo, Trat, Mukdahan, Songkhla, Chiang Rai, Nhong Khai, Nakhon Phanom, Kanchanaburi, and Narathiwat. Originally, incentives comprised of eight years of corporate income tax exemptions and 50% reductions on corporate income tax for the following five years (CIT is currently 20%); import duty exemption on machinery and raw materials; double deductions from the costs of transportation, electricity and water supply for 10 years; an additional 25% cost deduction for installation or construction of facilities.

As investor interest has been lukewarm, the Government, through the Board of Investment of Thailand, strengthened the incentives. For instance, operations of an eligible entity located in an SEZ will be entitled to a reduced 10% CIT for a period of 10 years on net taxable income derived from qualifying revenue. Other privileges include an exemption from import duties on machinery, a five-year exemption for raw or essential materials for use in the production of exports and a permit for the employment of unskilled foreign workers at promoted projects. The

[105] Available from **http://www.ey.com**. Global Tax Alert, 19 May 2015.

Government has assigned the Treasury Department to allocate land to government agencies for use, or for the Industrial Estate Authority of Thailand or other government agencies or the private sector to rent and develop the area in accordance with set criteria and rental rate.

Among the targeted sectors in SEZs are: agriculture and fisheries; ceramics; furniture; textiles and garments; leather; medical equipment; automobiles and parts; jewellery; electronics and electrical goods; plastics; pharmaceuticals; logistics; industrial estates; and tourism related business.

The SEZs have come under criticism. First, the newly government appraised land values for SEZ's have gone up by 50%, in some cases increasing by 90%, against a national land appraisal average increase of 25% going into effect in January 2016.[106] Second, there are concerns that the relative remoteness of the SEZs (i.e. the absence of strategic locations) may fail to trigger investor interest. Third, locals near the proposed economic zones in some areas said they feared their livelihoods would soon be changed forever as people would have to move away from their land. They were also worried about the future environmental impact of the industrial estates.[107] Fourth, the attracted industries continue to rely on labour-intensive industries which may not be competitive with lower wages in neighbouring countries. The Thailand Development Research Institute (TDRI) noted that using SEZs as a base for labour-intensive industries could miss the mark, as Thailand's production costs were 15 times higher than those of Cambodia and Lao People's Democratic Republic. In addition, TDRI noted that the Government should move away from labour-intensive industries and focus on developing value-added and innovative products from the knowledge-based sector to enhance the country's competitiveness.[108]

For a full overview of the SEZs and available incentives and zone designation criteria, see Board of Investment of Thailand, a Guide to Investment in the Special Economic Zones (August 2015) which is available from: **http://www.boi.go.th/upload/content/BOI-book%202015_20150818_95385.pdf**.

Source: online resources (see footnotes in text).

- SEZ regimes should be flexible, allowing a range of commercial as well as manufacturing activities. Ideally, modern SEZs should become part of national and subnational innovation systems, with focus on R&D, compliance with international standards and availability of certification agencies, and training of SEZ personnel.
- Incentives can be provided through regulatory and administrative incentives and facilitation rather than fiscal incentives; business development services (including facilities for R&D and skills development) are more important than tax incentives. Incentives should be performance based (see section B).
- Zones should not replace efforts to implement trade and investment reform in the whole country. They can be used as a testing ground to see what reforms could work on an economy-wide basis. The success of the economic zone is determined by the extent it can create linkages with the local economy (OECD, 2010).
- Domestic (SME) suppliers need the required capacity to meet prevailing industry standards. SMEs in the zone or supplying companies that are resident in the zone may also need access to incentives such as duty-free imports and tax privileges. The clustering effects may be so strong that foreign investors are willing to invest in the area even if the policy environment or location is less attractive (Yehoue, 2009).
- Services industry and FDI in services are becoming increasingly important. However, there is no explicit need to have SEZs to develop services.
- Legal restrictions for domestic investment in SEZs need to be lifted while labour markets need to be flexible: seamless movement of labour between the zones and rest of the economy. There should be no discrimination between foreign and local companies in treatment. Zones should preferably have a multi-market orientation, not just for export.
- Logistics costs are sometimes higher than manufacturing costs. SEZs need to address logistics, i.e. location and multi-modal transportation links as well as proximity to distribution channels and sales support are important.

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[106] Available from **http://blog.findyourspace.co/2015/11/special-economic-zones-in-thailand-sez**.

[107] Pratch Rujivanarom, The Nation, 18 November 2015; **http://www.nationmultimedia.com/national/SEZ-proposals-strike-fear-in-villagers-30273187.html.**

[108] Pathom Sangwongwanich, "Planned border SEZs no magic bullet." TDRI press release, 23 June 2015. **http://tdri.or.th/en/tdri-insight/planned-border-sezs-no-magic-bullet-says-tdri**.

- SEZs need to be aligned with changing competitiveness as a result of FTAs, in particular mega-regionals such as the ASEAN Economic Community, Trans-Pacific Partnership and Regional Comprehensive Economic Partnership.
- SEZs should provide necessary infrastructure and common services. However, they do not address the need for investment facilitation and cutting red tape. In addition, skilled labour supply is another prerequisite which does not automatically come with SEZs. SEZs can only be effective with a proper and competent management structure.
- SEZs need independent regulatory bodies backed up by law. The regulatory authority may be different from the development agency.
- The private sector should take the lead in development and management; public-private partnerships for infrastructure development and financing work best under proper management and regulatory structures.
- Zone authorities should have sufficient autonomy, particularly over staffing, budgets, spending, and policymaking. An independent board should oversee the operations of the zone authority. The board should comprise of key government ministers and private sector representatives and report to the highest level of government. Ideally, private sector representatives should constitute the majority of board membership to ensure flexibility, results-orientation, and customer-focus.
- Zone designation criteria are helpful in fulfilling zone objectives. Such criteria address requirements for area, space and site allocations, locations, usage of facilities, residents, type of business and investors, sewage and waste water disposal, wages and labour conditions, public utilities, time indications for development, etc.
- Zones should be managed on a cost recovery basis and should be customer focused. Cost recovery basis is enhanced by limiting subsidies and charging fees that are based on market prices.
- Proper coordination mechanisms among government agencies involved in policymaking, investment, trade, zone development, land development, labour, finance and customs etc.) should be established. Proper coordination between national and local government is also necessary.
- Environmental and social sustainability is essential for SEZs but often lacking. Full transparency is required in construction, bidding and operations. Involvement of local communities in the establishment of zones and land purchases, relocation and determining compensation strategies is also required.
- SEZs need to comply with international standards and rules, i.e. prevailing FTAs and WTO (e.g. TRIMS, SCM Agreement), ILO (on labour standards).
- SEZs should be demand-led. The information contained in the feasibility study should be used in master planning and development phasing and (a) should be based on “real-world” financial and economic-impact analyses; (b) ensure that public investments in infrastructure are economically efficient; (c) analyse potential market appetite and demand (both “pent-up” and existing) for investment in manufacturing and commercial sectors bearing in mind the improved business environment offered by an SEZ regime.
- Hence, the purpose of demand assessment is to: identify the main target sectors for investment at SEZs; determine investors’ critical investment drivers and constraints; Estimate investor demand for serviced land (m^2), pre-built facility space (m^2), and utility services in two 20-year scenarios: a base case – likely scenario and an aggressive case – best-case scenario.

D. DISCUSSION ISSUES

1. What incentives does your country use to attract FDI? What criteria are used for foreign investors to qualify for different kinds of incentives? Are these incentives in compliance with international legal requirements? Are these incentives a drain on the national budget or worth the tax revenue and other economic benefits obtained from foreign investors? What metrics and data collection methods do you use to assess the impact of economic and social costs and benefits?

2. Does your country impose performance requirements on foreign investors? If so, what kind of requirements? Do you consider these requirements restrictive or conducive to sustainable development? Have they undermined the inflow of desirable FDI? Are your country’s incentives linked to performance requirements?

3. Does your country have special economic zones of any kind, such as EPZs? If so, what is the objective of these zones? What is your experience with the establishment, governance and operation of such zones? Do you think there is a proper level of coordination among concerned bodies, such as EPZ boards, government ministries, private sector developers and operators? Do you think the regulatory framework for such zones is satisfactory?

4. Have SEZs in your country been successful in attracting FDI? Are they demand-driven? Have they contributed to economic/sustainable development, e.g. through labour creation and forging effective linkages with domestic companies?

5. Has your country conducted a cost-benefit analysis of SEZs? Are they developed in strategic areas or in underdeveloped areas? What have been the social and environmental impacts of these zones? Is your country implementing policies/adopting legislation to make such zones more sustainable?

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CHAPTER SIX

6 INVESTMENT PROMOTION AGENCY ROLES, STRUCTURE AND MANAGEMENT

A. INVESTMENT PROMOTION AGENCY ROLES AND FUNCTIONS

While an attractive and conducive investment climate is essential for the attraction of FDI, countries have increasingly competed through active investment promotion, targeting and facilitation. For that purpose, most countries have established investment promotion agencies (IPAs) with various mandates and institutional set-ups. The World Association of Investment Promotion Agencies (WAIPA) has 170 member IPAs from 130 countries. Of ESCAP's 53 regional members, 50 have IPAs (exceptions are Nauru, Tuvalu and Democratic People's Republic of Korea).[109] IPAs are often created through special legislative acts, usually as part of a wider general foreign direct investment promotion act, code or law (see chapter 4 and box 6.1).

In order to keep investment laws concise, it is better to have separate acts establishing IPAs, in particular as IPAs usually focus on attracting FDI while investment laws may cover both foreign and domestic investment (Daniel and Forneris, 2010). These acts explicitly specify the institutional structures and functions of IPAs and set the broad parameters for the types of activities they can engage in (VCC and WAIPA, 2010). IPAs are not normally involved in formulating FDI policies and development goals. However, they are playing an increasingly important role in policy advocacy (UNCTAD, 2008a).

Box 6.1. Legal basis and functions of selected Asia-Pacific IPAs

In **Bangladesh**, the Investment Board Act 1989 established the Board of Investment (BOI) as the principal private investment promotion and facilitation agency of the country. The Act mandated BOI for providing diversified promotional and facilitating services with a view to accelerating industrial development of the country. In particular, BOI undertakes the basic functions of investment promotion, provides information to investors, acts as a one-stop centre for approvals, registrations and permits, including access to land and sites, and undertakes policy advocacy. (**http://boi.gov.bd**).

In **Cambodia**, the 1994 Investment Law established the Council for the Development of Cambodia (CDC). This law made the CDC the highest decision-making level of the Government for private and public-sector investment. It is chaired by the Prime Minister and composed of senior ministers from related government agencies. The Cambodian Investment Board (CIB) and the Cambodian Special Economic Zone Board (CSEZB) are the CDC's operational arms for private sector investment. CDC/CIB undertakes basic investment promotion and facilitation services, e.g. provides information services to investors, processes and approves investment applications and grants incentives. (**http://www.cambodiainvestment.gov.kh**).

In **Georgia**, the Georgian National Investment Agency was established in 2002 as a Legal Entity of Public Law (LEPL – organization created on the basis of corresponding law, separated from state management, performing public authority independent of state control). Its establishment is not covered under the country's principal FDI law, i.e. the 1996 Law of Georgia on the Investment Activity Promotion and Guarantees. In 2015, the Agency moved under the direct supervision of the Prime Minister of Georgia and is the only official state agency responsible for promoting and

[109] Available from **http://www.waipa.org/members-list**.

facilitating foreign direct investments in Georgia. The Agency plays a role of moderator between foreign investors and the Government of Georgia. It undertakes active investment promotion and provides information to investors and comprehensive aftercare services. It also facilitates the search for local partners. (**http://www.investingeorgia.org/en**).

The principal IPA in **Malaysia** is the Malaysian Investment Development Authority (MIDA), incorporated as a statutory body under the Malaysian Industrial Development Authority (MIDA) Act in 1967. The functions of MIDA are: (a) to promote foreign and domestic investment in the manufacturing and service industries in Malaysia; (b) to undertake planning for industrial development; (c) to recommend policies and strategies on industrial development; (d) to evaluate, manage and grant licenses and incentives for industrial investment projects; (e) to assist companies in the implementation and operation of their projects; and (f) to facilitate the exchange of information and coordination of concerned public and private agencies. (**http://www.mida.gov.my**).

In the **Republic of Korea**, the Foreign Investment Promotion Act (FIPA) is the basic law pertaining to foreign investment. The Act establishes "Invest Korea," a one-stop investment promotion centre within the Korea Trade-Investment Promotion Agency (KOTRA) to assist foreign investors. In particular, Invest Korea provides information to and seeks domestic partners for interested investors (pre-investment consultation), organizes site visits and issues registration certificates (investment execution), and provides investment facilitation and aftercare services (post-investment service). (**http://www.investkorea.org** and **https://www.kotra.or.kr**).

In **Sri Lanka**, the Board of Investment (BOI) was established through the special Board of Investment of Sri Lanka Law of 1978, last amended in 2012. The BOI undertakes core investment promotion and facilitation functions and acts as a one-stop shop for obtaining approvals and permits, visa facilitation, site and environmental clearances, legal services, industrial relations, zone management, and search for local partners. (**http://www.investsrilanka.com**).

In **Thailand**, the Board of Investment (BOI) was upgraded under the revised Investment Promotion Law of 1977 with the Prime Minister as the Chairman and the Minister of Industry as the Vice Chairman. In 2014, the Office of BOI was transferred from the Ministry of Industry to the Prime Ministers' Office. The BOI implements investment policy and manages and issues investment incentives. Apart from active investment promotion, it provides information to investors and provides business support services, including helping investors linking up with domestic partners and suppliers. (**http://www.boi.go.th**).

Sources: Countries' national IPA websites.

Broadly, the principal purposes and functions of IPAs are: (1) Marketing the host country/area as an attractive competitive investment destination; active and pro-active investment promotion and image building (roadshows, investment forums, visits to investors, brochures), and, ideally, investor targeting; (2) Provision of essential investment and investment related information (investment climate, policies, procedures and laws); (3) Investment approvals, registrations, screening and evaluation; (4) Other regulatory functions: managing and granting incentives, issuing regulations; (5) Arranging site visits for investors; (6) Act as a one stop shop for investment facilitation (permits, registrations, licenses, visas); (7) Provide aftercare services (investor service centre, ombudsman, grievance panels/bodies, etc.); (8) Undertake policy advocacy (making policy recommendations); (9) Investment policymaking (not common but some IPAs do this, in particular in Singapore); (10) Additional functions which are not investment related, i.e. trade promotion (some IPAs are both trade and investment promotion agencies). In more advanced countries, IPAs also promote outward FDI. Essentially, the IPA is an intermediary between the investors and the host country environment (figure 6.1). However, as explained in chapter 4, the most effective IPAs do not normally undertake policy and/or regulatory functions as the needs for these functions are sharply divergent from those related to investment promotion and combining both functions in one institution may lead to a conflict of interest.

Ideally, the key functions of an IPA fall into six main categories (figure 6.2). Governments need to carefully consider how to optimize these six function categories to achieve maximum results.

(1) Strategy

The prime function of IPAs is to develop and implement an effective investment promotion strategy. In order to do that, the IPA requires a clear and comprehensive understanding of both the national and international policy contexts and how these affect the country's potential to attract the desired quality and quantity of FDI (as set by policy). It also requires the identification of key sectors to target for inward investment (Loewendahl, 2001).

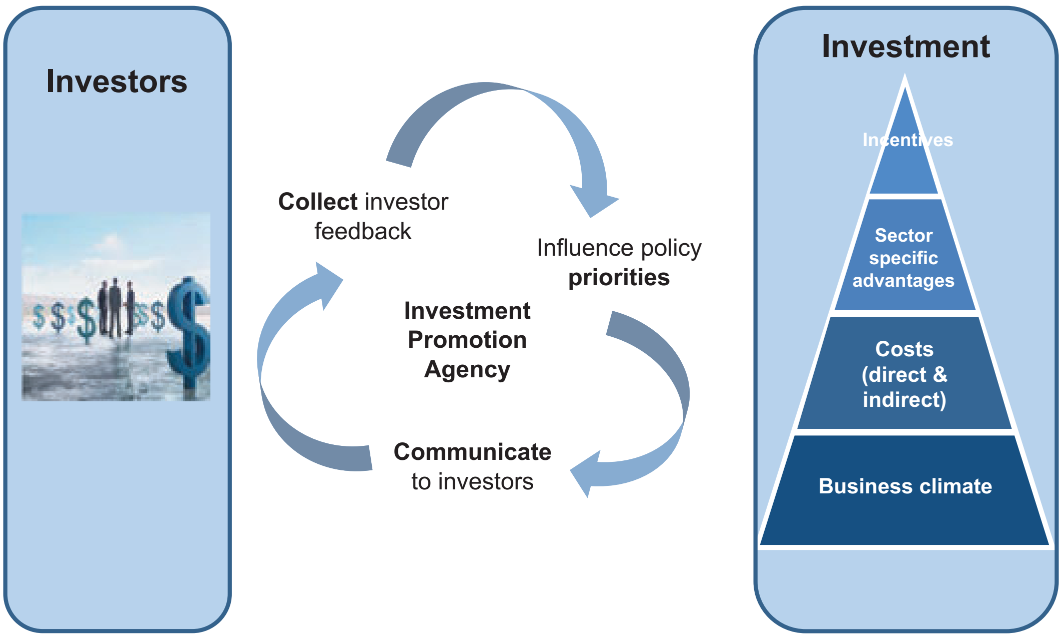
(2) Organization and coordination

A government needs to create an effective IPA that is responsible for attracting inward FDI. Some best-practice organizational principles include a clearly defined role and mandate, clearly assigned responsibilities and functionalities for a single agency and access to expertise and information to act independently from third-parties. Strong linkages with both public and private stakeholders are crucial. In addition, IPAs need to coordinate subnational IPAs and national level government agencies and ministries to formulate a coherent and consistent policy approach to FDI (Zanatta and others, 2006).

(3) Image building and marketing

The third core function of an IPA is image building and marketing. This is associated with both creating awareness of the IPA's role and coverage area among potential investors and providing marketing and promotion materials on the country's investment climate to investors. Marketing serves as an "awareness creation tool" and aims to build an attractive image of the host country (VCC, 2009). Different marketing techniques exist to accelerate the process of image building and place branding (chapter 7).

Figure 6.1. The role of IPAs as an intermediary



Source: Inter-American Development Bank: **http://www.probarranquilla.org/expoprobarranquilla2013/downloadableFiles/virtualZone/ponencias/4.%20Tendencias%20de%20la%20Promocion%20de%20Inversion%20%20e%20IED%20a%20nivel%20mundial.pdf.**

(4) Investor targeting

Investor targeting is a frequently applied tool which allows for the efficient utilization of limited resources based on prioritization. It entails both attracting specific industries and companies in specific industries. This involves the identification of niche businesses or businesses that possess competitive advantages in the IPA's region as well as industries that have been defined as a priority in the country's investment policy. Investment targeting requires the establishment of personal networks and relations with both existing and target investors and most importantly to stay in contact with these investors on a sustained basis (see chapter 7).

(5) Investment servicing (facilitation)

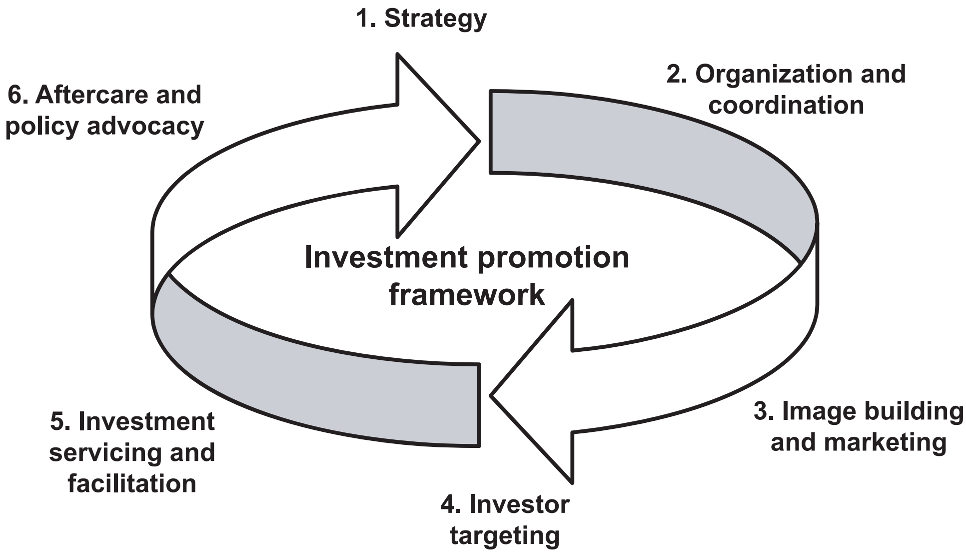
Truly realizing investments from leads that have been generated by investor targeting requires active investment facilitation. The key objective of investment facilitation is to convert an investment inquiry into an actual investment. Successful approaches include appointing key accounts or key management to every serious inquiry, lead or potential project. Understanding the investors' requirements, providing appropriate information, arranging site visits, establishing one-stop shops and developing ready-made tailored packages are essential

steps to achieve effective investor facilitation (Loewendahl, 2001). Providing relevant information is particularly important as TNCs often do not have sufficient information to compare locations and sites for their investment. IPAs should fill that gap (Zanatta and others, 2006). Chapter 8 discusses investment facilitation in detail.

(6) Aftercare and policy advocacy

Investment facilitation does not stop once the investment has been realized. Aftercare usually refers to all activities that lead to generating, retaining and expanding leads as well as to build a local supply network. The principal aim of aftercare is investment retention and expansion. Aftercare also allows IPAs to identify and address obstacles faced by existing investors in their daily operations and formulate policy recommendations accordingly. See chapter 7 for details.

Figure 6.2. Framework for investment promotion: functions of an IPA



Source: Loewendahl (2001); VCC (2009).

The focus on those six specific functions varies by country group. For instance, according to UNCTAD's survey (2001), while IPAs in OECD countries usually focus on investment targeting and aftercare programmes, IPAs in LDCs have been more concerned with investment promotion, investment policy recommendations and positive image building. Some IPAs have wide-ranging functions. For instance, in Papua New Guinea, the Investment Promotion Authority has diversified roles and functions. It is the organization that houses the Companies Office of PNG, the Securities Commission of PNG and the Intellectual Property Office of PNG. It is also the point of identification of markets for PNG exports and dissemination of investor-related information about PNG.[110] Figure 6.3 shows the investment promotion cycle and the role of IPAs.

IPAs in countries at higher levels of development and already significant inflows of FDI tend to focus on aftercare and investment retention and expansion. In those countries, typically more attention is paid to linkage programmes and promotion of higher value-added investment.

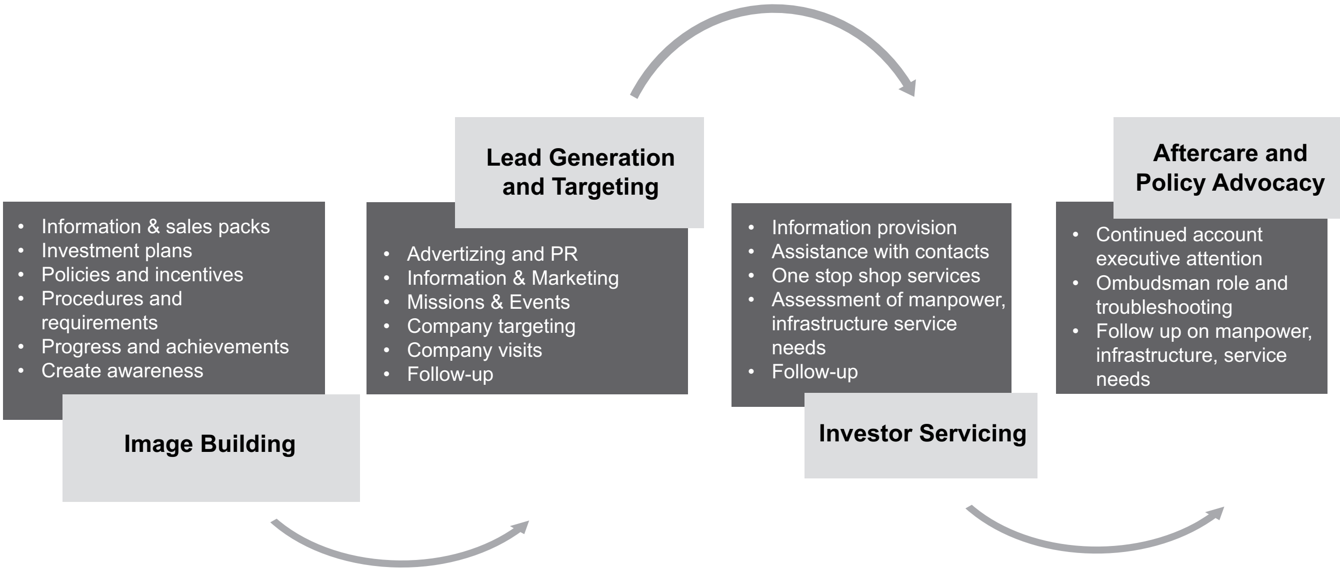
Consequent chapters will elaborate on these roles and functions.

B. DEFINING ORGANIZATION PRINCIPLES OF THE INVESTMENT PROMOTION AGENCY

The IPA needs to be organized in such a way that it is an effective and efficient institution in attracting investment. This is more easily said than done. "Attracting investment is a challenging resource intensive activity. It requires a diverse range of skills and a high level of professionalism and commitment. Defining the organization principles (e.g. vision, mission, goals, etc.) is crucial to create shared values and to differentiate an IPA from any

[110] Available from **https://www.ipa.gov.pg**.

Figure 6.3. Investment promotion cycle and the role of IPAs



Source: Investment Consulting Associates.

others. When investment promotion is done well, the benefits for the local economy can be significant. In addition, the work realized by IPA staff can be satisfying and rewarding, often opening up excellent career prospects." (VCC, 2009). For starters, the IPA needs to clearly define its vision, mission and purpose (i.e. goals and objectives). What is the IPA for, what is it supposed to do and achieve? In this regard, it is important that the IPA's goals and activities are realistically described in the context of the current investment climate, available resources and skills and development priorities.

1. Vision and mission statement

Each IPA should consider the **vision** for its organization and/or location. A vision must be a concise but clear statement of what the organization intends to become and to achieve at some point in the future. It is thus a future-oriented description of a main outcome the organization wants to accomplish. Most visions these days refer to sustainable economic development goals and expected benefits to the people of FDI.

The **mission** statement should be an inspiring statement of how the vision will be achieved. A mission statement can also refer to a particular set of higher level goals that need to be achieved in order to realize the vision. Ideally, mission statements should be simple, short and concise, and clear and known to all employees of the IPA. They should reflect the uniqueness of an organization as much as possible.[111]

In practice, visions, missions and goals are often mixed up or overlapping and, clearly, there is a close mutual relationship. For that reason, various IPAs choose to have only a mission statement and no vision statement. Some IPAs provide rather lengthy mission statements which replace goals. Box 6.2 provides some examples of current IPA vision and mission statements in the region.

111 See, i.e. **https://www.extension.iastate.edu/agdm/wholefarm/html/c5-09.html**.

Box 6.2. Vision and mission statement of selected IPAs in Asia-Pacific

Cambodia: Council for the Development of Cambodia (CDC)/Cambodia Investment Board (CIB) (**http://www.cambodiainvestment.gov.kh/about-us/who-we-are.html**):

Vision: "Our vision is to be the Government Investment Promotion Agency with efficient and effective work and outputs, delivering benefits to the people of Cambodia through increased investment.

Our *Purpose* is to manage the Cambodian Government's private sector investment policy and help attract and retain productive private sector investment."

Georgia National Investment Agency (Invest in Georgia): (**http://www.investingeorgia.org/en/agency/about-the-agency**):

No vision
Mission: Promoting investment climate and opportunities of Georgia internationally; Supporting foreign investors before, during & after the investment process; Creating an investment portfolio consisting of projects initiated by Government; Fostering public-private dialogue in order to build a better and more prosperous environment for private sector development and economic growth.

Kyrgyzstan Investment Promotion Agency (**http://www.kgembassy.org/wp-content/uploads/2015/07/Legal-aspects-of-Doing-Business-in-Kyrgyzstan-aspects.pdf**):

Mission: "Our mission is to support economic growth by increasing foreign investment in Kyrgyzstan's economy."

Vision: "Our Vision is to become the most reliable long-term partner of foreign investors."[112]

Malaysian Investment Development Authority (MIDA) (**http://www.mida.gov.my/home/about-mida/posts**):

Vision: The best partner to investors distinguished by the integrity and professionalism of its people.

Mission: To ensure Malaysia achieves its goal in economic transformation and its aspiration of a developed nation by 2020.

Pakistan Board of Investment (**http://www.boi.gov.pk/AboutUs/AboutUs.aspx**)**:**

Vision: Promoting domestic and foreign investment to enhance Pakistan's international competitiveness and contribute to economic and social development.

Mission: Policy Advocacy: achieve steady improvements in the investment environment by: proposing measures to create a steadily improving investment friendly environment; removing and simplifying outdated unnecessary procedures, approvals and legislation; facilitating a greater private sector role in industrial zone development.

Investment Promotion: Provide exemplary leadership as the apex investment promotion body by: implementing proactive cost effective responsive and targeted promotion strategies; delivering effective investor facilitation services on behalf of the individual investor; creation of a centralized databank.

Philippines Board of Investment (**http://www.boi.gov.ph/index.php/en/about-boi/mandate.html**):

No vision
Mission: **"**We, the BOI family are committed to generate local and foreign investments and develop globally competitive industries, thus, increasing employment through the responsible use of the country's resources, guided by the principles of private initiative and government cooperation.

In pursuit of these commitments, we bind ourselves to render competent and efficient service with utmost integrity and professionalism.

Ours is a challenging task, yet with discipline and the guidance of an enlightened and strong leadership, we shall move forward."

Sri Lankan Board of Investment (**http://www.investsrilanka.com/about_us**)**:**

Vision: "To make Sri Lanka the most preferred destination for sustainable investment in Asia".

Mission: "Attract and secure sustainable investments for optimum utilization of resources and talents, through vigorous promotion and excellent investor facilitation whilst preserving harmony with the natural environment as a significant contributor in the development of the national economy".

Sources: websites of countries' national IPAs.

[112] Kyrgyzstan Investment Promotion Agency lists the mission before the vision statement.

2. Goals and objectives

Goals are general statements of what the IPA wants to achieve. As such, they need to be integrated with the IPA's vision and mission. Goal setting is the major outcome of strategic planning, after gathering all necessary information. Goals should be:

- **Suitable**: to meet the vision and mission statements;
- **Acceptable**: Does it fit with the values of the company and the employees?
- **Understandable**: Is it stated simply and easy to understand?
- **Flexible**: Can it be adapted and changed as needed?[113]

Objectives and goals are often used interchangeably but they can be distinguished. Objectives are specific, quantifiable, time-sensitive statements of what is going to be achieved and when it will be achieved. They are milestones along the path of achieving the goals. They can be viewed as intermediate goals. Both goals and objectives should be SMART to be effective:

- **Specific**: precise about what has to be achieved;
- **Measurable**: clear on how to quantify the realization of the objective;
- **Agreed or achievable**: realistic expectations;
- **Relevant:** to the organization and to whom they are assigned;
- **Time-based**: clear indication of start and finish date.

In addition, objectives should be suitable to meet the goals that need to be achieved.

Goals are often confused with activities and services. Typical goals for an IPA are:

- Deliver high quality investor services;
- Develop marketing and promotion material of a specific location;
- Perform research and gather data and follow up on investor inquiries;
- Organize (web) events and investment seminars;
- Develop and maintain a high-quality website;
- Track and trace investor inquiries and assist in site visits.

However, these so-called "goals" rather refer to the services and activities of the IPA and often do not meet the SMART criteria. Box 6.3 gives examples of cited goals of selected IPAs in Asia-Pacific.

An example of a useful SMART goal would be: to expand FDI in (sector) in (location) by x% by (end date), i.e. to expand FDI in the textile and garment sector in Bangladesh (or a specific SEZ) by 5% by the end of 2020/2030. Goals can also refer to the expansion of employment through FDI, the expansion of business linkages, or transfer of technology or given amount of capital inflows or any other higher economic goal but this is normally not advisable. However, in order to enhance the contribution of an IPA to promoting sustainable FDI as a means to achieve sustainable development, VCC-WAIPA (2010) have argued that goals should reflect sustainability and contain both quantitative and qualitative aspects related to sustainability. After all, it is no longer just the quantity of FDI attracted that matters but also the quality.

An IPA exists to promote FDI and its goal should therefore reflect the results of its efforts towards the promotion and attraction of FDI. The Kyrgyzstan Investment Promotion Agency refers to expanding public-private partnerships (but as a function rather than a goal) and has a whole website dedicated to this goal (box 6.3).[114]

It can be argued that in practice it is perhaps not essential for IPAs to state explicit vision and mission statements and goals. After all, all that investors really care about is what IPAs can do for them, i.e. the services IPAs can provide. However, a clear vision and mission statement shows a certain level of professionalism and purpose of the IPA which sends a message to investors that the IPA is a serious and professional agency.

[113] Available from **https://www.extension.iastate.edu/agdm/wholefarm/html/c5-09.html**.

[114] Available from **http://www.ppp.gov.kg/en**.

Box 6.3. Examples of IPA goals

Kyrgyzstan Investment Promotion Agency (http://www.kgembassy.org/wp-content/uploads/2015/07/Legal-aspects-of-Doing-Business-in-Kyrgyzstan-aspects.pdf):

Goals:

- To facilitate investment in Kyrgyzstan's economy;
- To promote local investment opportunities and to improve Kyrgyzstan's business image;
- To assist local companies to develop their businesses.

Functions:

- To search for and attract foreign investors to implement investment projects in Kyrgyzstan;
- To promote Kyrgyzstan in the international economic environment;
- To participate in supporting investment projects implemented through the PPP model;
- To provide support in obtaining necessary approvals and to remove the barriers to investment;
- To assist investors to solve their problems;
- To provide consulting and information services to investors;
- To conduct expert assessment of business plans and investment projects.

Sri Lanka's Board of Investment key objectives (http://www.investsrilanka.com/about_us):

- Foster and generate economic development;
- Widen and strengthen the base of the economy;
- Encourage and promote investment, specifically Foreign Direct Investment (FDI);
- Promote interdisciplinary interaction and collaboration;
- Help existing enterprises in dealing with macro socio economic challenges and help in their transformation;
- Diversify the sources of foreign exchange earnings and increase export earnings;
- Promote innovation and the adoption of new technologies and generate new employment;
- Establish Investment Promotion Zones (IPZs) throughout the country especially through public and private partnership;
- Promote Sri Lanka as a trading hub.

Sources: websites of countries' national IPAs.

3. The Client Charter

A client charter is a kind of "letter of engagement" that informs potential investors about standards and the delivery of products and services. It also indicates what the IPA, in turn, expects from its clients to meet its commitments to them and sets targets for service delivery. In particular, the Charter sets out:

- what the IPA will do for investors;
- how it proposes to do it;
- in what timescale.

The Charter is a way of ensuring that:

- The IPA creates and maintains a client focus;
- It communicates effectively with clients;
- It maintains levels of service above pre-determined service expectations;
- Its programme and service portfolio is tailored appropriately to client needs.

Box 6.4 gives an example of a typical client charter.

Box 6.4. An example of a client charter: MIDA

We are committed to provide services in a professional, efficient and ethical manner to industrialists and potential investors in the manufacturing and services sectors by:

- Responding to all investment enquiries in a prompt and courteous manner;
- Disseminating accurate and up to-date information on investments;
- Assisting investors in the implementation of their projects.

We are committed to answer relevant enquiries, and to complete the evaluation of applications from the date of complete information received, within the stipulated time-frame as follows:

- Enquiries received via website – 2 working days
- Manufacturing licence
  - Normal track – 4 weeks
  - Fast track – 7 working days
- Incentives – 6 weeks
- Tax exemption from custom duties – 4 weeks
- Principal hub – 6 weeks
- Regional Office and Representative Office -– 4 weeks
- Expatriate posts
  - Normal track – 4 weeks
  - Fast track – 7 working days

Source: Available from **http://www.mida.gov.my/home/client-charter/posts**.

C. REQUIREMENTS FOR AN EFFECTIVE INVESTMENT PROMOTION AGENCY

1. Status and position

In most countries, IPAs are part of the government and often placed within line ministries. However, given the coordinating role of IPAs and the special nature of investment promotion, many agencies have requested a higher level of independence or autonomy. The most effective IPAs are indeed those that enjoy independent status and report directly to the Head of Government or State (Daniel and Forneris, 2010). Those IPAs are also able to create corporate office cultures and to attract staff from the private sector by offering competitive salaries (UNCTAD, 2001). In some cases, investment promotion is subcontracted to a private sector firm. In that case, the government saves money and leaves the job of promoting private investment to people who know what business needs. However, a private sector run IPA basically provides a public good and has limited bargaining power with public sector institutions (UNCTAD, 2001).

As discussed before, IPAs usually fall under the responsibilities of the ministries of economic affairs, industry, planning, trade and investment, finance or foreign affairs. These ministries allocate the agencies' budgets. Heads of IPAs consequently report to the respective ministry and budgetary changes are at the ministry's discretion. For example, China's Investment Promotion Agency is hosted by the country's Ministry of Commerce. Viet Nam's Foreign Investment Agency is hosted by the Ministry of Planning and Investment. The Philippines Board of Investment is hosted by the Department of Trade and Industry. In some cases, IPAs are placed directly under the President or the Prime Minister's Office as is the current case with the boards of investment in Pakistan and Thailand. This may increase the status of the agency, in particular in matters requiring coordination and cooperation from line ministries, but also has its drawbacks when too many decisions depend on interference from the highest office in government. As for more independent agencies, they still often rely on public funds, though the reporting arrangement through public-private sector boards of directors provides them with more financial independence (UNCTAD, 2001).

In some cases, IPAs manage to supplement their income from proceeds of services rendered and from contributions from other parties, including international aid. Examples of IPA services for which agencies charge their clients include various business services, legal assistance, help in carrying out feasibility studies and support in the identification of qualified local personnel. It is debatable to what extent such services should be paid for by

the investor or by the government (UNCTAD, 2001). It probably depends on how attractive the host country/ location is for investors. Locations with superior investment climates and strong determinants for FDI would logically be in a better position to charge for services than locations that are struggling to attract FDI and need compensating factors.

In large countries, the need for effective investment promotion has often led to the development of subnational IPAs, which promote regions, provinces or states, or even municipalities within a country (box 6.5). As locations within countries differ in characteristics, advantages and disadvantages, a case can indeed be made for subnational IPAs. While such subnational IPAs may play a role in investment promotion, their value added would be more prevalent in the area of investment facilitation and aftercare, in particular when the investment approval is made in by the national IPA. VCC (2009) prepared a handbook for the promotion of FDI for Promoting Foreign Direct Investment in Medium-Size, Low-Budget Cities in Emerging Markets which contains a chapter on the establishment of IPAs at the municipal level.

Subnational IPAs may be subsidiaries of the national IPA but often they are not. Competition among IPAs representing different regions can be detrimental to a country's overall development (Zanatta et. al, 2006). National IPAs usually play a coordinating role vis-à-vis subnational agencies to avoid unnecessary competition and to direct investors to local agencies (UNCTAD, 2001). However, in practice such coordination is difficult and requires effective communication channels. During the implementation of an ESCAP project on promoting FDI in Viet Nam in 2000-2002[115], it was found that the lack of effective coordination and communication between the Ministry of Planning and Investment and the individual departments of planning and investment (DPIs) of the provinces' People's Committees proved a bigger problem than communications between investors and these government agencies. Similar problems were found in Cambodia and Lao People's Democratic Republic though in these countries the Central Government assumed greater authority than the provinces.

Box 6.5. An example of a subnational IPA: Zhejiang International Investment Promotion Centre, China

Zhejiang International Investment Promotion Center (ZIIPC) was established in 2001 under approval of the People's Government of Zhejiang Province. As a state-run institution affiliated to the Department of Commerce of Zhejiang Province, the Center undertakes an important task of introducing the investment environment and industrial policy of Zhejiang Province, attracting foreign investment, and encouraging local enterprises to "Go global", thus realizing leapfrog development. With the new service system of "One Acceptance, Whole Services", ZIIPC consists of eight departments and affiliations, namely Administration Department, Foreign Investment Promotion Department, Outward Investment Promotion Department, Liaison Department, 96357 International Investment Public Service Platform, Zhejiang Complaint Center for Foreign-Invested Enterprises (Complaints Handling Department), Zhejiang International Investment Service Center, Zhejiang Commercial Human Resources Exchange Service Center, the last two of them have established branches all around the province and extensive business network nationwide.

Its main responsibilities are:

1. Implementing state policy, laws and regulations investment, introducing investment environment and industrial information of Zhejiang Province.
2. Assisting foreign institutions and investors with business visits in Zhejiang Province, supporting Department of Commerce of Zhejiang Province, Bureau of Commerce of prefecture-level cities and economic zones to implement high-quality programmes by project promotion and follow-up service.
3. Implementing the "Go Global" strategy advocated by the provincial government, creating favourable conditions for Zhejiang enterprises who intend to be listed overseas, do transnational business, contract projects and export labour, helping lower the cost of going global and offering quality services.
4. Promoting two-way investment by organizing activities in multi-forms, both at home and abroad.
5. Providing services for foreign investors, i.e. project consultation, technology assessment, market analysis, feasibility study, procedure agent, administrative application and approval;
6. Offering agent service in establishing and registering foreign-invested enterprise and foreign representative offices in Zhejiang Province; offering human resources management services for Chinese employees.

[115] Forum for the Comprehensive Development of Indo-China, phase V. This is a large-scale programme of assistance funded by the Government of Japan.

7. Providing human resources outsourcing services for domestic organizations, i.e. state-owned institutions, non-state enterprises and private companies.
8. Organizing two-way investment promotion related business training and overseas training for senior personnel, the test and certificate issuance of national freight forwarding qualification and dispatched labour; organizing various forums on foreign-related economy.
9. Handling complaints of foreign investors; providing legal consultation and agent service in lawsuit and arbitration;
10. Responsible for directing and liaising investment promotion and complaints handling organizations at national, provincial and municipal level, as well as at provincial economic development zones in Zhejiang.

Source: Available from **http://www.zjfdi.com/news/20131114/n41851672.html**.

Finally, in order to effectively reach out to potential investors, a large number of IPAs have established overseas offices. Overseas offices are better able to target and connect with potential investors and hence, to undertake effective image building and investment promotion. However, they are expensive to maintain and therefore usually do not exist for LDCs. In the UNCTAD survey (2001) only one out of five agencies in Asia-Pacific reported had an office in one of its neighbouring countries, which suggests that investment promotion efforts in the region are usually carried out by the home office. However, it is not always necessary to have a full-fledged office in target countries. In many cases, having one or two highly qualified investment promotion officers associated with overseas embassies of the host country in the target country may suffice. Finally, IPAs are increasingly outsourcing investment promotion activities to specialized lead generation consultancy firms which are more performance-oriented and can help generate large cost savings.

There are basically four common types of IPA positions within the overall government institutional structure.

(a) Integral unit of a major ministry (e.g. Industry, Trade, Finance, Planning, Economic Development, Foreign Affairs, etc.);
(b) Unit within the Prime Minister's or President's office;
(c) Separate ministry;[116]
(d) Autonomous agency.

Each type has advantages and disadvantages (see table 6.1).

Table 6.1. Advantages and disadvantages of various types of IPA status

1. Integral part of an existing ministry	
Advantages	**Disadvantages**
• The IPA's status within the government is clear to other parts of the government. • The IPA is well placed to influence the ministry's internal policies that are relevant to investment attraction. Issues can be resolved "in-house" thereby avoiding discussions between government agencies that may have competing agendas and objectives. • Investment promotion is more likely to be viewed as a priority by the minister. Because the newly established IPA has been added to the ministry's portfolio, the minister feels a strong sense of ownership of investment-related issues. • In most cases, an IPA can be established within an existing ministry without the need for enabling legislation.	• A ministerial office is unlikely to be well suited to the business-oriented initiative-taking style common to most successful IPAs. • Civil service procedures are often slow and cumbersome. An IPA needs financial autonomy to allocate its budget without approval of each decision by a central financial body. For example, the chief executive should be able to schedule an overseas visit by an employee without having to refer to other individuals in the ministry or civil service. • It may be more difficult to recruit executives with private sector experience to work in a public-sector institution. Most successful IPAs worldwide have a mix of talented individuals from both the public and private sectors.

[116] This type has become increasingly rare. In Viet Nam before, the Ministry of Planning and Investment was responsible for investment promotion until it established the specialized Foreign Investment Agency within MPI. In Sri Lanka, there is a Ministry for Enterprise and Investment Promotion which nominally oversees the Board of Investment but the Ministry actually in charge of FDI is the Ministry of Finance.

Table 6.1. *(continued)*

2. Establishing the IPA in the office of the Head of Government/State	
Advantages	**Disadvantages**
• Association with the prime minister's or president's office increases the status and potential influence of the IPA. • Because the IPA is not associated with the agenda of any one ministry, it is better able to coordinate among ministries and argue the case for change with ministries whose policies or regulations interfere with effective investment promotion or implementation. Other ministries are less likely to view the IPA as an agent of a competing ministry's agenda. • Foreign investors tend to like the idea that the IPA is at the centre of government, because it sends a signal that FDI is a priority for the government. • The IPA probably can be set up without the need for special legislation.	• There is a danger that too many routine decisions will be referred upwards to busy members of the Head of Government's immediate cycle of advisers. As a result, these decisions may be delayed. Furthermore, this may also undermine the sense that operational decisions are the responsibility of IPA staff. • The IPA may be constrained by civil service procedures that can be slow and cumbersome. An IPA needs financial autonomy to allocate its budget without approval by a central financial body. • It may be difficult to recruit executives with private sector experience to work in a public sector institution. Most successful IPAs have a mix of talented individuals from both the public and private sectors. • It may be difficult to avoid having negotiations on large projects be unduly influenced by short-term political considerations, rather than by economic and commercial criteria. This can result in pressure to grant overly generous concessions.
3. Separate ministry	
Advantages	**Disadvantages**
• The IPA has an individual identity with its own budget. It is also seen as an integral part of government in its own right, rather than as an adjunct of another ministry. • The IPA has its own minister to argue its case within the government. • The IPA can take up the case of individual investors without influence from other agendas that might constrain it if it were a unit within a larger ministry.	• The IPA will be a small ministry in terms of its portfolio and budget, and may consequently be headed by an individual minister with limited status. The ministry may still report to a larger ministry and be headed by a junior minister with insufficient clout to make the case for FDI. • The IPA may still operate under civil service procedures. As a result, it may lack the financial autonomy it needs to allocate its budget without approval by a central financial body. • The IPA's public-sector status is likely to make it difficult to recruit executives with private sector experience. • This structure may make the IPA more sensitive to short- term political considerations. This may affect its negotiating position with large potential investors. Thus, the IPA may focus more on the short-term political gains from "landing" a large project, rather than on the project's longer-term economic and commercial impact. As a result, overly generous concessions may be offered to a foreign investor.
4. Autonomous agency	
Advantages	**Disadvantages**
• The IPA has a distinct identity, its own budget, and its own chief executive officer and board. • It can be run with more flexible procedures than a government department can; it can hire staff from both the public and private sectors; and it can authorize needed expenditures. • The IPA is better able to lobby publicly for necessary changes in the business environment than it could if it were embedded in a government department. • As a separate, accountable body, the IPA's performance is likely to be more open to parliamentary and public scrutiny. • It should be possible to persuade talented private sector leaders to serve on a board of directors or advisory board and to recruit private sector staff on contract rather on civil service terms.	• This model may not work well under governments unfamiliar or inexperienced with the concept of an autonomous agency. In such a case, an autonomous IPA may be marginalized and may not have the same influence over government policy as would an agency located within a ministry. However, precisely for that reason it would be unlikely that an autonomous IPA would be set up in the first place in such a situation. • This model often does not work effectively because the IPA is not given sufficient statutory power to approve investments, grant concessions, or issue other approvals that remain the responsibility of other government departments. As a consequence, this type of IPA can be perceived by potential investors as simply "one more stop" in the investment approval process.

Source: Multilateral Investment Guarantee Agency. *Investment Promotion Toolkit*, No. 2. Developing an Investment Promotion Agency (2000); Daniel and Forneris (2010).

From the above analysis, research and experience, it follows that an autonomous agency with legal identity and high degree of operational independence, granted with sufficient statutory power, staff, resources and mandate is potentially the most effective type of IPA (Daniel and Forneris, 2010). The effectiveness of IPAs is further enhanced when the agency reports to a supervisory board that includes representatives of the private sector. In particular, the higher the number of private members, the greater IPA effectiveness. As an autonomous body, it also has more authority to coordinate among line ministries and other agency, in particular when it reports directly to a country's head of state or government.

2. Structure and staffing

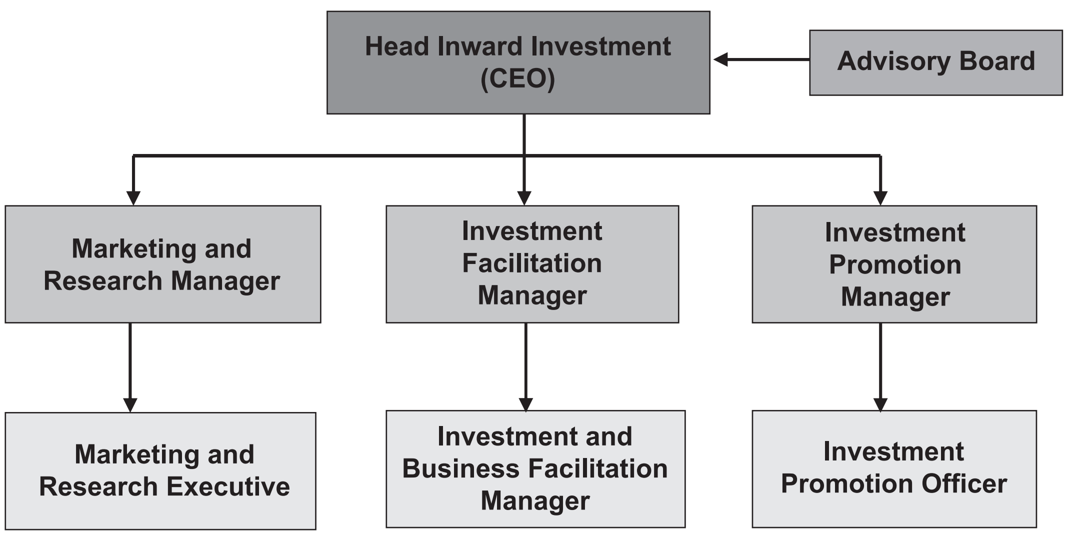
It is a fallacy that bigger IPAs are better. In most cases, smaller IPAs with competent staff and sufficient resources perform better than large IPAs with a lot of staff and resources (box 6.6). At a minimum, the IPA should have the following key positions (VCC, 2009):

- Head of office: chief executive officer;
- Investment Promotion Manager, who handles investor inquiries and has the responsibility to generate new inquiries (investor targeting);
- Investment Facilitation Manager, who assists an investor with all the regulatory, permitting, legal, and operational issues of setting-up a new operation in the provinces;
- Marketing and Research Manager, who provides the research and marketing collateral in order to promote the location and meet the information requirements of investors.

If the budget allows, the IPA can add additional staff to support the work of the managers as presented figure 6.4.

The marketing and research manager undertakes relevant research for investors and develops the website. This manager could also, over time, build up a databank of information and facts about the country/location. He/she is also responsible for identifying and networking with other organizations and for building relations with the leading foreign and domestic investors already in the country. The Investment Promotion Manager undertakes the activities associated with investment promotion, i.e. image building, developing investment promotion strategy and investor targeting. The Investment Facilitation Manager takes care of site visits and aftercare (VCC, 2009).

Figure 6.4. Basic structure of a small IPA



Source: VCC (2009); Investment Consulting Associates.

A small IPA will have limited staff and hence should take care that resources are used efficiently. While the IPA could undertake active investment promotion, its focus should ideally be on facilitating investor inquiries, as these inquiries are from investors who clearly have an interest in investing and are considering various investment locations (box 6.6). The project manager should take the lead in handling these inquiries, with support from an investment officer where resources allow (VCC, 2009).

Box 6.6. Best practice IPA: Invest in Austria (ABA)

Austrian Business Agency (ABA) or Invest in Austria is the government-owned national IPA of Austria with about 30 staff undertaking investment promotion and helping investors set up business in Austria. It reports directly to the Ministry of Science, Research and Economy.

The services provided by ABA are free of charge. They provide professional consulting services to firms interested in setting up business operations in Austria, focusing on all issues relevant to selecting an appropriate location. The team focuses on attracting investors from Asia, Canada, Europe, and the United States. It has overseas offices in New York, Shanghai and Tokyo. Staff have overlapping geographical and sector/functional responsibilities. Special regional focus is on Germany with two different departments for North and South Germany. Asia, Latin America and United Kingdom are combined. Europe is split in three regions: Italy and Southern Europe, Western Europe (except United Kingdom), and Central and Eastern Europe. Core sectors are automotive, financial services, chemicals, electronics, logistics, mechanical engineering, mechatronics, ICT and telecom, life sciences and tourism. A special "Location Austria" team promotes Austria as an optimal hub for international film productions, offering advisory services on selecting suitable film locations (www.locationaustria.at). Separate departments exist for start-ups, corporate development, communications, information management and research, and administration. The agency is headed by a managing director.

The budget for the Agency was €4.3 million for 2016. Out of this, €2.5 million went to staff salaries, 1.2 million for investment promotion, 300,000 for office rent and general expenses, 200,000 for public relations, brochures, etc., 100,000 for work under the Austrian Film Commission and 1.2 million for investment promotion. Under the investment promotion budget, 140,000 was used for promotional events, 510,000 for consultants, 170,000 for direct marketing, 210,000 for travel expenses, 20,000 for aftercare, 70,000 for information and data services and the rest for other expenses like restaurants, phone and so on.

The Global Investment Promotion Benchmarking 2009 report of the World Bank Group ranked ABA-Invest in Austria as the top global performer among 181 investment promotion intermediaries (World Bank, 2009). According to an ABA press release, total investments in the first half of 2016 more than tripled compared to the previous year with 164 new foreign investment projects, a rise of 8% from the previous year resulting in 1,046 new jobs. Germany remains the main investor country, followed by Italy.[117]

Source: Available from **http://investinaustria.at/en**.

The **Advisory Board** assumes the role of Board of Directors when the IPA is not autonomous (e.g. part of a ministry). An Advisory Board is, as the name suggests, advisory (not statutory) and has the following functions:

- Offer advice to CEOs and ministers of agency's/department's proposed business plan and implementation;
- Alert the minister to the concerns of existing and new investors about government policies, laws, regulations and bureaucratic procedures;
- Provide comments and advice on issues brought to its attention by the CEO or the minister;
- Publish a short annual report commenting on the performance and prospects of the agency/department.

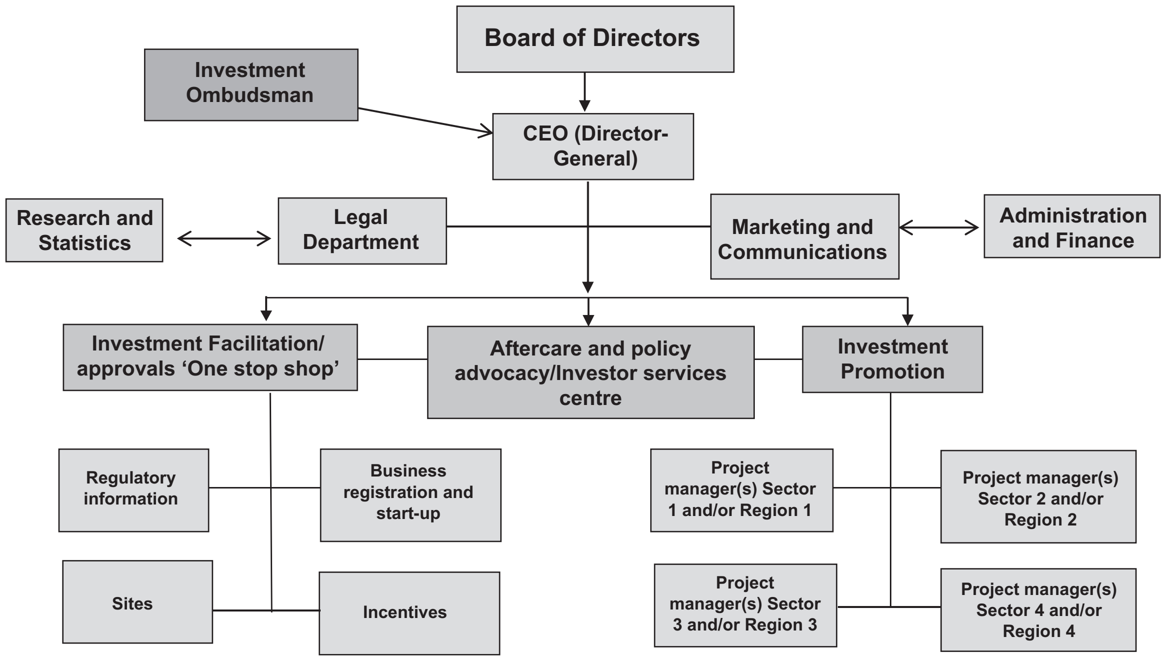
The Board should meet regularly, i.e. once a month. The government must set clear ground rules governing board members' use of commercially sensitive information provided by investors.

Ideally, though, the IPA should be autonomous. This is the preferred organizational structure for larger, well-funded countries and provinces. However, this option is the most resource-intensive, and will require significantly higher budgets to cover the cost of additional staff and a dedicated office, utilities, etc., separated

[117] Available from **http://investinaustria.at/en/press/press-releases/half-year-results-2016.pdf**.

from other offices (VCC, 2009). At a minimum, the national IPA would need 10-20+ full time staff to justify this option, while a subnational or municipal IPA would need 10+ full time staff. Many IPAs are organized by sector and/or region. In smaller IPAs, staff members often have both geographic and industry/sector specializations. An example organization structure for a larger national IPA is shown in figure 6.5. VCC (2009) specifies the roles and functions of the various segments of the IPA.

Figure 6.5. National IPA best practice organizational structure



Source: VCC (2009); Investment Consulting Associates.

The **Board of Directors** is similar to an Advisory Board but more typical for an autonomous IPA. Board members ideally consist of a mix of senior government officials from relevant agencies and private sector. The Chairperson should be from the business community and well respected, and should have no conflict of interest (be no minister etc.). The Board performs the following functions:

- Policy advocacy: draw the attention of the government to policy, regulatory and bureaucratic obstacles to new and existing FDI and investors;
- Approve the annual business plan prepared and proposed by the agency's executive officers;
- Provide advice to the CEO and access to business networks;
- Provide assistance in the implementation of the business plan;
- Publish an annual report detailing the agency's activities and accomplishments for that year.

The **Chief Executive Officer** (CEO) can be from the private or public sector. He/she should have fluency in English, a pro-active attitude, be savvy with media. He/she should have in-depth knowledge of international business and know how to prepare and conduct meetings and strategic conversations with senior executives of major companies. He/she is responsible to the Board (and through the Board to the sponsoring ministry) and accountable to the Board or a minister and has direct access to the minister. The CEO typically performs the following roles:

- Present the annual business plan, annual report, and quarterly monitoring reports to the Board;
- Act as the principal public representative of the IPA;
- Manage the agency financially, strategically and the staff;
- Personal involvement in big investment proposals;

- Undertake overseas promotion visits;
- Undertake policy advocacy and develop relations and contacts with key agencies in government and private sector, at home and abroad.

The **Legal Department** provides legal advice to investors and is in charge of approving investment projects and granting licenses.

The **Administration and Finance** Unit is headed typically by a Finance Director or Chief Financial Officer. The unit is responsible for finance, human resources, systems, infrastructure; planning and policy, servicing Board of Director meetings, preparation of annual reports, and providing training. In many IPA's a lot of resources are exhausted on administrative procedures by over-skilled employees. Nevertheless, this is an important back office function across all divisions.

The **Marketing and Communications** team plays a key role in the provincial IPA. Its members have responsibility for the marketing programmes, which can include: provision of promotional propositions; organizing and attending events; and developing a communication strategy. For small and medium-sized agencies, marketing also has a responsibility for research. Marketing therefore has a crucial role in supporting the activities of the project managers.

Research and Statistics is a critical function and includes: preparing statistics, collecting data for analysing (domestic, regional and global) investment trends and tracking investment by type, origin, destination, amount, approved vs. realized etc.; designing, maintaining FDI and location databases; conducting research and data provision for individual investors; identifying and profiling target investors; and eventually collecting data for monitoring and evaluation.

The **Investment Facilitation Department** provides the core function of the IPA. Facilitation services are provided by a team responsible for processing any permits or licenses which investors may need, as well as providing other facilitation services such as incentives applications, site acquisition and leasing. Depending on the size of the organization, the investment facilitation team may also get involved in areas such as immigration. The team can act as the main source of information on the regulations for the investors to implement and operate their investment project. It is important that this team works in coordination with the project managers and as efficiently and transparently as possible, to ensure seamless implementation of investment projects.

Investment facilitation also incorporates **aftercare**. The scope of aftercare services can be comprehensive and extensive and forms an important part of the role of the IPA. Some IPAs have established specialized **investor services centres** to assist investors in the post-approval set-up and operations phase of the investment. Aftercare also involves the provision of an ombudsman to hear grievances and complaints from investors. In ideal cases the ombudsman reports directly to the CEO. Chapter 8 discusses investment facilitation and aftercare issues more comprehensively.

IPAs cannot always act on the complaints from investors. However, they can play an important role in **policy advocacy** which is directly linked to aftercare. UNCTAD (2008a) defines policy advocacy as "IPA efforts to effect changes in regulations, laws, government policies and their administration, pertaining to fields such as investment, trade, labour, immigration, real estate, taxes, infrastructure, technology and education. The immediate goal of this advocacy is to shape a climate conducive to attracting and benefiting from FDI. The ultimate goal is to make FDI work for the socio-economic development of the host country." Research suggests that policy advocacy influences FDI inflows more than other IPA functions (Morisset and Andrews-Johnson, FIAS, 2004). UNCTAD (2008a) distinguishes three goals of policy advocacy:

(a) Shaping the investment climate to attract greater inflows of FDI;
(b) Promoting policies that allow greater benefits to be extracted from FDI;
(c) Building national and/or regional competitiveness in the global economy.

"IPAs have a combination of access and understanding of business and political stakeholders that may be unparalleled in most countries. This gives them a unique position not only to act as messengers between the private sector and Government, but also as drivers of the changes needed for economic growth and development" (UNCTAD, 2008a).

For the purpose of policy advocacy, UNCTAD (2008a) proposes a four-step process: (a) problem-identification and agenda-setting, which requires frequent interaction and consultation with investors; (b) developing the best policy remedy based on established criteria (e.g. expected impact); (c) consensus-building

through policy dialogues and public-private sector forums; and (d) monitoring and evaluation. The UNCTAD guide can be accessed at: **http://unctad.org/en/docs/iteipc20076_en.pdf.**

Project managers are key staff responsible for handling investor inquiries, working with investors to implement their projects, and for pro-active investor targeting. Project managers also form the team in charge for delivering aftercare. For larger organizations, project managers can be divided into regional or sector targeting teams, with dedicated project managers for each region/sector being targeted. Project managers should act as account executives for individual investors.

3. Skills and equipment

IPAs essentially face three major management challenges in effectively performing their role and functions: human capital, structural capital and relational capital (table 6.2).

Table 6.2. Management challenges for IPAs

Needs/challenges	
Human capital	• Building new skills and capabilities in existing employees; • Hiring new employees with appropriate backgrounds (technological and scientific awareness; language abilities; business experience).
Structural capital	• Developing new targeting tools and checklists; • Developing and standardizing new services; • More flexible and customized forms of intervention; • New performance measurement and evaluation systems.
Relational capital	• Emphasis on subsidiary development/aftercare/reinvestment; • Closer interaction with other spheres of government.

Source: Investment Consulting Associates. Presentation made by Charles Krakoff at International Best Practices for Building and Managing an IPA Workshop Presentation to Warmia and Mazury Economic Forum, Poland, 10-11 June 2015. Available from **http://investinwarmiaandmazury.pl/Photos/Attachment/694ec403-2a87-4496-9c61-0ccff4e3934d-IPA-Best-Practices-Poland-Investment-Conference-2015.pdf**.

Obviously, the effectiveness of an IPA is determined by the skills of the staff. Staff require different skills sets depending on their specific role in the IPA. For instance, marketing staff should have degrees in marketing and excellent communication skills. Qualified IT staff are required to maintain the website. Both investment promotion and investment facilitation and aftercare officers need to have profound knowledge of investor concerns and investment location decisions and have in-depth knowledge of the sector and enterprises they are targeting. Investment facilitation and aftercare officers should also have legal expertise as many investor queries relate to legal issues. They should also have expertise in networking to fulfil the expectations of a one-stop shop. More generally, with regard to standard investment promotion and facilitation, staff should have or develop the following skills:

- Excellent command of spoken and written business English and other languages of principal investors targeted (e.g. Japanese, Korean, Chinese);
- Able to use client-relation management (CRM) and client tracking for facilitation, aftercare, and accountability;
- Able to undertake competitive location benchmarking;
- Able to undertake IPA benchmarking and improve IPA performance;
- Able to effectively and efficiently organize exhibitions, events and seminars and develop and deliver attractive, concise and informative presentations to attract FDI;
- Understanding business structures and forces of competitiveness;
- Understanding foreign investors' decision-making processes and business life-cycle;
- Understanding sustainability issues, national development plans and priorities and thorough knowledge of international principles of responsible business conduct;
- Able to anticipate and satisfy investor enquiries;

- Able to use advanced promotion techniques to generate investment leads;
- Able to lobby and advocate improvement in the investment climate;
- Able to undertake investor targeting by specific regions, industries and companies;
- Able to establish and manage local linkages programmes;
- Able to network with local, national, and international partners and stakeholders, in particular national and local government ministries and agencies and business associations, chambers etc.

Promising staff that do not meet all qualifications required for a specific post need to undergo training and IPAs should have dedicated budgets for training purposes. Table 6.3 shows specific job descriptions and qualification for two key positions in an IPA related to investment facilitation (rather than promotion).

Finally, the IPA should be equipped with proper facilities, technologies and equipment, including:

- A central location easily reached by private and public transport;
- A dedicated telephone number with extension for each staff member;
- Dedicated office with meeting space and appropriate signage on office and front of building;
- Networked computer system with advanced and up-to-date software and databases;
- Customer relationship management (CRM) system;

Table 6.3. Job descriptions and qualification for two key IPA positions

Investment Centre Director	
Job description: • Provide overall direction to Investment Centre, reporting to Chairman; • Prepare annual work plan. • Assign clients/prospects and tasks to staff; • Co-ordinate with other units in provincial/regional government (e.g., IT and web services, operational departments); • Responsible for dialogue with business associations and other external stakeholders; • Lead client-facing promotion, facilitation, and aftercare activities; • Set and oversee research agenda and activity; • Evaluate staff performance and prepare individual staff training plans.	**Qualifications**: • Master's degree in business, economics, management, or related discipline; • At least 7 years' experience in private business or state-owned enterprise, focusing on marketing, public relations, investor relations or similar area; • Experience with customer relationship management (CRM) systems; • Fluency in written and spoken English; other languages (Chinese, Arabic, Turkish, Korean, German, French) an asset; • Proven ability to manage professional staff; training experience a plus; • Knowledge of transport and logistics, energy, technology, and/or manufacturing industries a plus.
Senior investment officer	
Job description: • Support Investment Centre Director; • Serve as 'account executive' for high profile investment prospects and existing investors; • Draft position papers on investment climate and policy reform issues; • Maintain CRM system and ensure its proper use; • Lead research activities.	**Qualifications**: • Master's degree in business, economics, management, or related discipline; • At least five years' experience in private business or state-owned enterprise, focusing on marketing, public relations, investor relations or similar area; • Fluency in written and spoken English; other languages (Chinese, Arabic, Turkish, Korean, German, French) an asset; • Proven research and writing capabilities; • Knowledge of transport and logistics, energy, technology, and/or manufacturing industries a plus; • Experience with customer relationship management (CRM) systems; • Web design, database management, or other IT experience is a plus.

Source: Investment Consulting Associates (2015), Availble from **http://www.investinwarmiaandmazury.pl/Photos/Attachment/694ec403-2a87-4496-9c61-0ccff4e3934d-IPA-Best-Practices-Poland-Investment-Conference-2015.pdf**.

- Well-developed and attractive and interactive website – separate from but linked to provincial/municipal government and national IPA sites;
- Translating and interpretation services.[118]

4. Budgeting and planning

The preparation of the budget for the IPA requires a clear understanding of the essential cost items. These include (from most expensive to least expensive) (VCC, 2009):

- Staff costs (including training);
- Office costs and related overheads, utilities including high speed Internet access for all staff;
- Computers for all staff and ideally notebooks for project managers;
- Developing and maintaining an inward investment website and databases (investor tracking system);
- Marketing materials development and printing;
- Company car for taking investors on site visits;
- Telephone (local and international), postage, stationary and printing costs;
- Traveling locally to meet investors, and stakeholders;
- Translation into English of important legal and promotional documents.

Other core cost items include: travel for overseas investment missions; attending key international industry events; using a firm specializing in FDI to develop the website and prepare marketing materials; purchasing/ subscribing to some key sources of data and company intelligence (which can be rather expensive).

The total budget outlay for an IPA can range from $250,000 for a small one to $5 million+ for a full-fledged autonomous organization with 20-30 or more staff able to compete internationally for investment and engage in all activities in the investment promotion cycle (includes overseas offices and dedicated aftercare unit). A typical breakdown of the budget by cost item is 60% for staff, 20% on programmes, less than 20% for overhead, and 2% capital expenditure. By activity, a typical breakdown was 30% for investment promotion, 25% marketing, 20% for research, 20% for investment facilitation and 5% for aftercare. However, depending on the situation, a larger proportion could be accorded to aftercare (VCC, 2009).

Sources of funding for an IPA are typically the government budget, private sector contributions and resources from multilateral aid agencies. It is not advisable to charge investors a registration fee as this defied the purpose of an investor-friendly IPA.

An important aspect of IPA internal management would be planning ahead. This involves the development of an internal planning calendar (stating meetings of the Board and reports due), the establishment of statistical tracking mechanisms including management information systems, the establishment of internal rules and procedures (governing travel, entertainment, absence etc.); and eventually the establishment and regular updating of required ICT infrastructure (computers, laptops, mobile phones, printers, software etc.). Planning is further discussed in the next section.

D. PLANNING, MONITORING AND EVALUATING AN INVESTMENT PROMOTION AGENCY's PERFORMANCE[119]

1. Definitions and purpose of planning, monitoring and evaluation

Monitoring and evaluation (M&E) can help an organization extract relevant information from past and ongoing activities that can be used as the basis for fine-tuning, reorientation and future planning of activities and modalities to implement the activities. M&E is necessary to assess to what extent stated goals and targets have been achieved and what can be done or changed to achieve those goals/targets better, more effectively and more

[118] Available from **http://www.investinwarmiaandmazury.pl/Photos/Attachment/694ec403-2a87-4496-9c61-0ccff4e3934d-IPA-Best-Practices-Poland-Investment-Conference-2015.pdf**.

[119] The M&E of an IPA performance is strongly linked to M&E of individual investment projects though the KPIs are quite different. Nevertheless, an IPA's performance is often and obviously linked to the performance of the investment they managed to attract. For a more elaborate discussion of M&E of investment projects, see chapter 8.

efficiently. M&E are very closely linked to **planning**. While various definitions of planning, monitoring and evaluation exist, probably the most useful are the ones provided by UNDP (2009). According to UNDP, planning can be defined as the "process of setting goals, developing strategies, outlining the implementation arrangements and allocating resources to achieve those goals". Effective planning involves a number of different processes:

- Identifying the vision, goals or objectives to be achieved;
- Formulating the strategies needed to achieve the vision and goals;
- Determining and allocating the resources (financial and other) required to achieve the vision and goals;
- Outlining implementation arrangements, which include the arrangements for M&E progress made towards achieving the vision and goals.

As UNDP (2009) observes, good planning, combined with effective monitoring and evaluation, can play a major role in enhancing the effectiveness of programmes, projects, efforts and activities. Good planning helps organizations focus on the results that matter, while monitoring and evaluation help them learn from past successes and challenges and inform decision-making so that current and future initiatives can lead to better results.

UNDP (2009) defines **monitoring** as "the ongoing process by which stakeholders obtain regular feedback on the progress being made towards achieving their goals and objectives." MIGA (2000) maintains the relatively simple definition of "the routine checking of an agency's or activity's progress towards planned goals." The emphasis here is not merely on whether activities are actually undertaken but rather whether these activities contribute to achieving the stated goals or targets. In other words, monitoring refers to the progress towards achieving a goal and allows for corrective actions if it is found that progress is below expectation or lagging given the stipulated time period within a goal needs to be achieved.

UNDP (2009) defines **evaluation** as "a rigorous and independent assessment of either completed or ongoing activities to determine the extent to which they are achieving stated objectives and contributing to decision-making. Evaluations, like monitoring, can apply to many things, including an activity, project, programme, strategy, policy, topic, theme, sector or organization." MIGA (2000) defines evaluation as "the process of checking whether a project's objectives were achieved and, if they were, how efficient and economical the process was." UNCTAD (2008b) defines evaluation as a process that "involves determining as systematically and objectively as possible the relevance, efficiency, effectiveness, sustainability and impact of activities in light of their objectives." For IPAs, M&E can be applied to incentive schemes, performance requirements and to individual staff performance as well as goals of the IPA such as the amount of targeted FDI or number of TNCs in target sectors attracted and projects implemented. M&E of the higher goals of FDI attraction, such as the number and quality of linkages, technology transferred, employment generated, etc., should also take place.

Box 6.7 explains the interlinkages between planning, monitoring and evaluation. The main purposes of M&E of an IPA are presented in table 6.4.

Box 6.7. Understanding interlinkages and interdependencies between planning, monitoring and evaluation

Without proper planning and clear articulation of intended results, it is not clear what should be monitored and how; hence monitoring cannot

- be done well.
- Without effective planning (clear results frameworks), the basis for evaluation is weak; hence evaluation cannot be done well.
- Without careful monitoring, the necessary data are not collected; hence evaluation cannot be done well.
- Monitoring is necessary, but not sufficient, for evaluation.
- Monitoring facilitates evaluation, but evaluation uses additional new data collection and different frameworks for analysis.
- Monitoring and evaluation of a programme will often lead to changes in programme plans. This may mean further changing or modifying data collection for monitoring purposes.

Source: UNDP (2009).

Table 6.4. Main purposes of M&E of IPAs

Purpose	Modalities, requirements
1. Improving the IPA's services for investors.	• Feedback from investors about the quality of IPA's services; • Feedback from investors about additional services desired from the IPA; • Setting higher standards for the length of time required to complete various types of services for investors; • Appropriate number of staff members to provide services to investors: – Often a lack of account executives/case officers is a major constraint.
2. Strengthening the capacity of the IPA.	• Much of the feedback from investors about the quality of services can help identify areas for training of IPA staff; • Annual performance reviews of IPA staff also indicate human resource development requirements. • High-level IPA management training in specific areas.
3. Setting targets and goals for the IPA's investment promotion strategy.	• Compare actual outcomes from investment promotion activities with the original targets and goals: – Have you achieved them? If not, can you determine why? Shortcomings of the IPA? Global or regional factors beyond your control? • Revise annual or long-term goals and targets: – Make them more realistic or set more ambitious goals, depending on the outcomes of the evaluation. • Make adjustments to the IPA's strategies and projects to achieve the desired results.
4. Accountability of the IPA.	• As IPAs are almost always funded by tax payers, they are under public scrutiny, and issues such as financial accountability, efficiency and evaluation are becoming increasingly important. • IPAs are under increasing pressure to demonstrate impact, efficiency and effectiveness, heightening the role of monitoring and evaluation.
5. Improving the local investment environment.	• Major complaints or problems commonly encountered by investors indicate key areas in the investment environment in need of improvement: – Determine which are within your mandate and which ones need to be addressed by other agencies. • Findings from IPA's own evaluation can identify factors restricting the benefits from investment or insights on what works well: – What were the causes of the IPA not achieving its goals? Some may lie in the overall environment and not within the IPA – What were the success factors if the IPA surpassed its goals? Can these factors be strengthened to bring about even greater benefits?

Source: ICA/ESCAP; Loewendahl (2001).

In conducting M&E efforts, the specific areas to consider will depend on the actual intervention, and its stated outcomes. Areas and examples of questions include:

- **Relevance**: Do the objectives and goals match the problems or needs that are being addressed?
- **Efficiency**: Is the project delivered in a timely and cost-effective manner?
- **Effectiveness**: To what extent does the intervention achieve its objectives? What are the supportive factors and obstacles encountered during the implementation?
- **Impact**: What happened as a result of the project? This may include intended and unintended positive and negative effects.
- **Sustainability**: Are there lasting benefits after the intervention is completed?[120]

[120] World Bank **http://siteresources.worldbank.org/INTBELARUS/Resources/M&E.pdf**. See also, Austrian Development Cooperation, 2009.

The following guiding principles of a proper M&E framework can be distinguished:[121]

- It is **focused and feasible** in relation to your available resources so that it supports rather than diverts resources from action (i.e. make sure you focus information collection on what you 'need to know', not on what would be 'nice to know').
- It provides **useful and timely** information to improve group learning, group decision-making, and project design.
- It is **useable** by, and/or comparable to, data collected by other stakeholders so it contributes to the wider evidence base.
- It is **credible, valid and reliable** to the extent possible within your available resources.
- It is **sensitive** to unequal power relations when you collect information (i.e. ensure that you listen to investors who are smaller and do not have a strong voice).
- It is **ethical** e.g. in relation to data consent, and protection of confidential information.

M&E, if properly done, are essential for the IPA for the following reasons:

First, an M&E system enables the IPA to assess the progress towards its own defined goals, such as specific targets for attracting investment and the economic impact of investment in the community.

Second, M&E is critical to make appropriate adjustments to the IPA's plans, activities, and special projects. It helps prevent wasting resources by identifying problems early in order to re-direct or cancel unproductive or ineffective efforts and helps establish key lessons learned from completed projects and implications for improving future ones.

Third, formal M&E provides tangible evidence for making decisions on the best use of scarce resources.

Fourth, it provides valuable feedback to policymakers on how to improve the investment climate. The IPA can present accurate and comprehensive data and findings to support decision-makers in their choices.

And fifth, M&E increases the IPA's accountability and transparency. Releasing evaluation reports on activities or performance of the IPA demonstrates that the IPA is functioning openly and transparently; this will instil greater confidence in the public and business sectors.

In addition, there are other benefits of an effective M&E system:

- It measures progress towards internal and national goals;
- It provides information to the public and business sectors;
- It helps apply information to promotional campaigns;
- It improves future projects and programmes;
- It demonstrates that public funding is being put to good use (based on IPA's documented achievements);
- It helps benchmarking the IPA against others.

M&E allow an IPA to track the impact of its activities even though in practice this is not always easy. After all, how do you know whether a certain outcome is the result of your specific activity? You can use surveys but they will only tell part of the stories and may not reflect true opinion as investors will be careful not to upset their host country. UNCTAD (2001) notes that: "a key challenge for any IPA is to find an appropriate system for the M&E of its own performance. Investment decisions by firms are affected by a large number of factors and IPAs can therefore never fully claim the full credit from winning an investment project, even if they have played a significant role in the process. Moreover, it is particularly difficult to develop methods to assess not-for-profit activities, such as investment promotion." However, an effective M&E system also drives progress in the IPA's activities. With clear goals in mind and knowing that their performance is going to be measured, IPA staff members will have stronger motivations for performing well. Other benefits include generating quantified data to support decision-making, assessing progress towards the IPA's and national goals, using the positive findings to support investment promotion activities or image building, and comparing the performance of your IPA to others to extract lessons on how to be more competitive. When the IPA is externally funded, either from national

[121] Available from **http://www.geog.ox.ac.uk/research/technologies/projects/mesc/guide-to-monitoring-and-evaluation-v1-march2014.pdf**.

government resources or from overseas donors, funding agencies would like to know how effectively their resources were used towards achieving the stated objective. In order to obtain an objective assessment, a meaningful evaluation should be conducted by an external specialized agency.

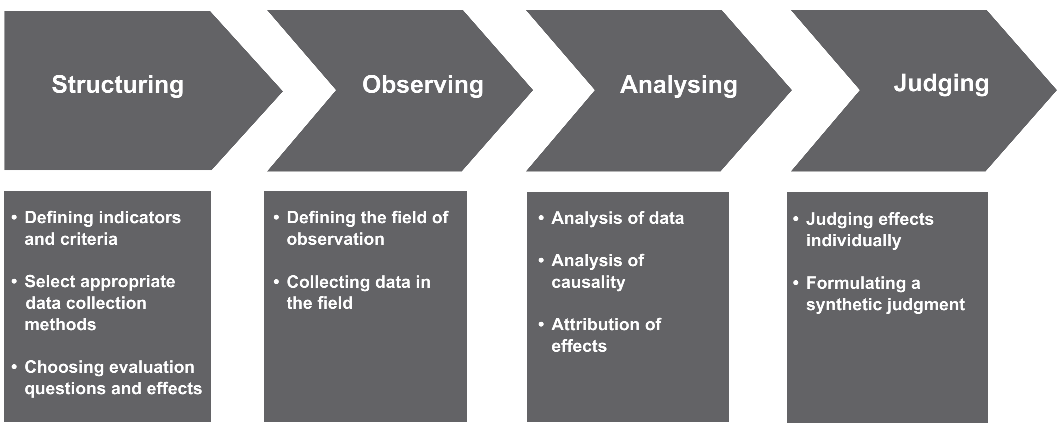
2. Evaluating an investment promotion agency's performance: a closer look

Broadly, four phases of evaluation can be distinguished as presented in figure 6.6. In addition, there are three broad types of evaluation that incorporate these phases.

Ex-ante evaluation, also known as programme design review, is a type of evaluation used *before* a programme is actually implemented to review its design and help prepare a finalized project plan. This type of evaluation is less common for IPAs, but it does provide substantial benefits when embarking on complicated programmes or projects to make sure they are designed properly. It is also known as **formative evaluation**. Formative evaluation is generally any evaluation that takes place before or during a project's implementation with the aim of improving the project's design and performance.[122] Formative evaluation is used to evaluate[123]:

- Whether the proposed message is likely to reach, be understood by, and be accepted by the target audience (i.e. the investor community);
- The best time to introduce a programme or new activity;
- Whether plans and strategies are likely to succeed;
- How investors get information;
- What kind of individuals investors would respect as account executives or IPA representatives;
- Whether there are unforeseen difficulties with materials, strategies, or mechanisms for distributing information.

Figure 6.6. Four phases of evaluation



Source: ICA.

Mid-term review evaluation is utilized around the mid-point of a programme or project cycle to assess what has occurred so far in terms of implementation and initial effects. This type of evaluation is important for making adjustments during the course of a programme or project to determine what, if any, changes need to be made to produce the intended outcomes. In some cases, the results of the mid-term evaluation will indicate that the programme or project cannot succeed under any circumstances and therefore should be terminated to conserve resources. Mid-term evaluation is closely linked to the monitoring process and builds on that process. Mid-term evaluation is also linked to **process evaluation** which is continuous and is also linked closely to monitoring and, basically, can be seen as synonymous to monitoring. Process evaluation will help the IPA determine whether its programme is effectively reaching the target investors. This type of evaluation should start as soon as the programme begins and continue for the duration of the programme. A process evaluation will:

[122] Available from **http://evaluationtoolbox.net.au/index.php?option=com_content&view=article&id=24&Itemid=125**.

[123] Available from **http://www.urbanministry.org/wiki/four-stages-evaluation**.

- Identify any problems that occur in reaching the target investors;
- Allow programmes to evaluate how well their plans, procedures, activities, and materials are working and to make needed changes;
- Show funding and donor agencies the programme's level of activity;
- Provide encouragement to participants;
- Reveal problem areas so that additional formative evaluation may be done.[124]

Ex-post evaluation or **summative evaluation** refers to looking back at a completed (or terminated) programme or project to determine the programme/project's impact, how well it was carried out, how efficiently the resources were used, understanding the logic between interventions and outcomes, and providing insights for subsequent phases of the project or new ones. Ex-post evaluation includes both **outcome evaluation** and **impact evaluation**. While outcome evaluation measures the IPA's progress toward achieving its goals and objectives against a baseline, impact evaluation measures the long-term and both intended and unintended programme effects.

Based on the above definitions, typology and descriptions, the interlinkages between planning, monitoring and evaluation can be elaborated a cycle as presented in figure 6.7. Here the interlinkages are presented as a cyclical process starting with establishing programme needs. This is part of the planning process and involves a needs assessment of the IPA's clients, i.e. the investors (or rather, a target group of investors). This ensures that programme activities lead to the expected outcomes that satisfy the needs of the target group. Evaluation efforts that aim to develop an effective programme are often collectively referred to as **developmental evaluation.**[125] Developmental evaluation is essentially the same as formative evaluation though the latter continues through the implementation of the programme. During the design or formulation of the IPA's programme an evaluation framework should be established. This involves an **evaluability assessment** which is meant to make sure that a programme is designed in such a way that the philosophy and policies behind it are well understood by stakeholders, and that one could determine whether or not it was successful, and by what criteria.[126] The next step is the implementation of the programme's activities and interventions. On the M&E side, at this stage, programme monitoring and process evaluation, including process and efficiency evaluation, take place. Finally, the results, outcomes, impact, effectiveness and sustainability of the programme need to be evaluated, which is summative evaluation. This involves cost-effectiveness evaluation to assess to what extent available and expended resources led to satisfactory results and outcomes.

The IPA must assess the results according to defined criteria. There are generally five ways to evaluate the results of a programme or project (or the IPA's overall performance) as mentioned before. First, the IPA can consider the **relevance** of the results. Were the outcomes appropriate to the needs, issues, and problems that the IPA was trying to address? According to UNDP (2009), an essential subcategory of relevance is the criteria of **appropriateness**, which concerns the cultural acceptance as well as feasibility of the activities or method of delivery of a development initiative. Second, the IPA can assess how **efficiently** resources were used in obtaining the results. Successful programmes might have used up more resources than desired to achieve the results or unsuccessful programmes might occur because of inefficient or insufficient resources. Third, the IPA can measure the **effectiveness** of its work by determining how the efforts have contributed to achieving the IPA's objectives. Fourth, the IPA can evaluate the **utility** or **impact** of its actions and outcomes for the whole community or location. Fifth, the IPA might want to assess the **sustainability** of the effects emanating from the programme or project. Will it have a lasting effect if it is closed down or does the activity need to be continued (Austrian Development Agency, 2009; UNDP, 2009)?

Evaluating effectiveness in project evaluations involves an assessment of cause and effect – that is, attributing observed changes to project activities and outputs. In this context, the issue of **attribution** is important, i.e. are the results achieved or observed really due to the activities of the IPA or due to some other external factor? Assessing effectiveness involves three basic steps (UNDP, 2009):

(a) Measuring change in the observed output or outcome;

(b) Attributing observed changes or progress toward changes to the initiative (project evaluation) or determining the IPA's contributions toward observed changes;

(c) Judging the value of the change (positive or negative).

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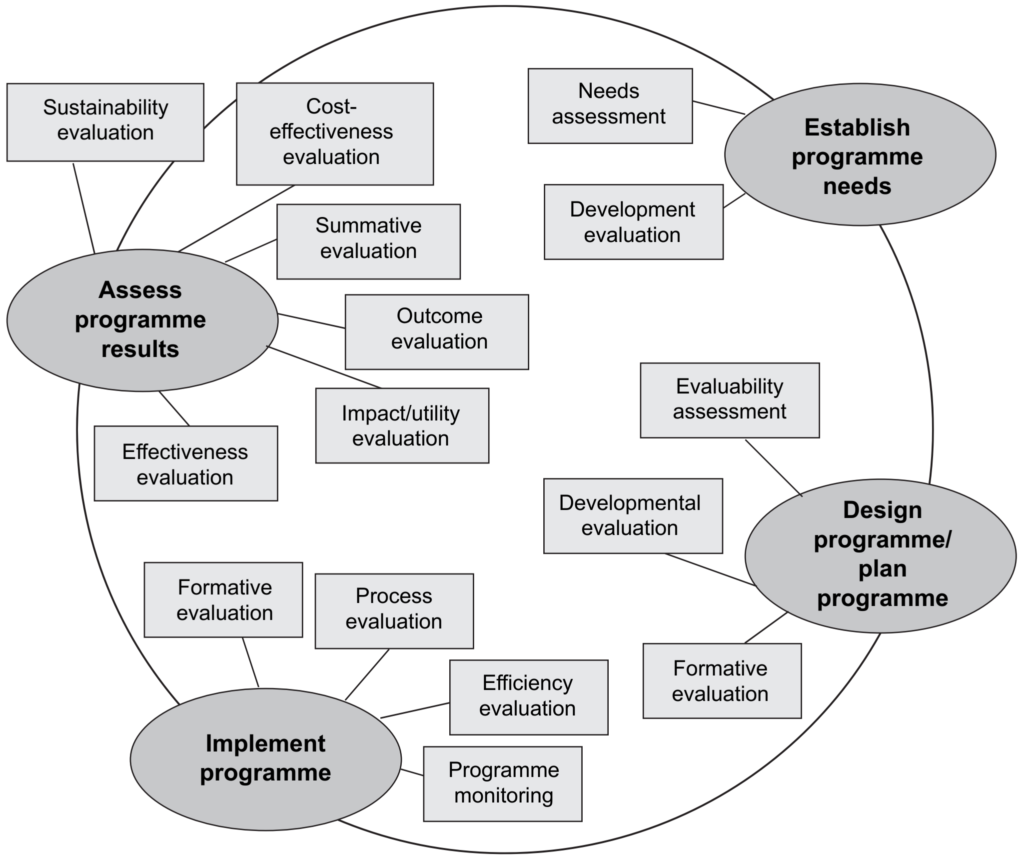
[124] Ibid.

[125] Available from **http://www.oninjuryresources.ca/downloads/publications/Eval_Toolkit_Stages_of_an_Evaluation.pdf**.

[126] Ibid.

Figure 6.7. The planning, monitoring and evaluation cycle



Source: Available from **http://www.oninjuryresources.ca/downloads/publications/Eval_Toolkit_Stages_of_an_Evaluation.pdf.**

Finally, it is important to decide who will undertake the evaluation. Individual account executives need to be actively involved in programme monitoring and it is the IPA itself which will send out evaluation questionnaires to stakeholders, in particular investors, and undertake the performance evaluation of individual staff. This is a process known as **internal evaluation**. However, in order to enhance the credibility of the IPA, an **external evaluation** undertaken by independent outside evaluators is also important and the IPA needs to budget for that exercise (box 6.8).

Box 6.8. Principles and quality criteria for evaluation

The principles and quality criteria for evaluation applied by the Austrian Development Agency (ADA) are based on those of the OECD Development Assistance Committee (DAC). While these principles and criteria refer to development assistance, they are also of relevance to IPAs.

- **Independence**: The planning and execution of an evaluation must assure the greatest possible objectivity and impartiality. Evaluations are therefore carried out by teams of independent, international experts with the collaboration of national experts from partner countries.
- **Credibility**: The evaluation team must be able to draw on the necessary (or required) methodological and subject-related knowledge and associated skills. The methods applied in the evaluation and its findings must be presented clearly in the evaluation report.
- **Participation**: Evaluation is designed as a process: External expertise and assessment is combined with a critical discussion by the project stakeholders (i.e. investors) to gain new perspectives and reach agreement on future work.

- **Transparency**: The subject, purpose, scope, addressees, evaluation questions, methods, schedule, qualifications of the evaluation team, reporting and coordination must be clearly defined in the terms of reference for the evaluation.
- **Ethics**: Evaluation should not reflect personal or sectoral interests. Evaluators must have professional integrity, respect the rights of institutions and individuals to provide information in confidence, and be sensitive to the beliefs and customs of local social and cultural environments (UNDP, 2009).
- **Reliability** refers to consistency of measurement—for example, ensuring that a particular data collection instrument, such as a questionnaire, will elicit the same or similar response if administered under similar conditions.
- **Validity** refers to accuracy in measurement—for example, ensuring that a particular data collection instrument actually measures what it was intended to measure. It also refers to the extent to which inferences or conclusions drawn from data are reasonable and justifiable.
- **Utility**: The evaluation findings should be useful for all stakeholders. Steps must be taken to ensure that they are implemented by the policy and operational decision-makers.

All evaluations include the international quality criteria of relevance, efficiency, effectiveness, impact and sustainability.

Source: Austrian Development Agency: **http://www.entwicklung.at/en/ada/evaluation**.

It is not always easy to determine what needs to be measured, as there are a number of possibilities and they might not always be apparent. The IPA can measure the inputs, outputs, and outcomes of programmes and investment strategies, specific programmes such as aftercare, or specific projects such as investment forums, or the overall performance of the IPA. The measurements and data collection tend to be a combination of quantified and qualitative data, depending on what is to be measured.

A considerable number of IPAs lack clear key performance indicators (KPIs) including key indicators of staff performance and a baseline against which progress can be measured. Such indicators could be either quantitative (e.g. number of investment projects, attracted capital, created jobs, tax revenues) or qualitative (e.g. priority or strategic types of industries and companies attracted, quality of created jobs). Most IPAs evaluate the success of their actions on the basis of investment announcements rather than realized investment projects as it often takes one to two years before an announced investment project is actually realized. In addition, IPAs measure the direct job creation, safeguarded jobs, and capital investment of these projects (Loewendahl, 2016a).

One potentially useful indicator to evaluate the efficiency of activities and services provided by IPAs is the period in which IPAs are able to respond to individual requests. Box 6.9 lists some possible indicators while box 6.10 lists major challenges and key requirements for successful evaluation. Annex tables to this chapter provide self-assessment frameworks for key roles and functions of IPAs. M&E of investment projects will be taken up in chapter 7.

Box 6.9. What should be measured? Some possible key performance indicators of IPAs

- Number of investments;
- Value of investment projects;
- Number of jobs created;
- Increase in tax revenue;
- Per capita income growth;
- Number of successful linkages with domestic companies;
- Investors' perceptions of the location;
- Investors' rating of IPA's services;
- Retention and expansion rates of investment projects;
- Conversion rates of...
  - Contacts becoming leads;
  - Leads making site visits;
  - Site visitors becoming investors.
- Policy or regulatory improvements in the investment environment
- National or provincial growth rates
- Sector growth rates
- Quality of investments (e.g., moving up the value chain)
- Sources of investment (greater diversity is better than reliance on one or two main sources)
- New spin off industries
- Sources of leads (forum, mailing, advertisement, etc.).
- Number of TNC headquarters established;
- Number of R&D facilities established by TNCs.

Source: ESCAP, ICA.

Box 6.10. Key challenges and requirements of IPA evaluation

Key challenges (as reported by IPAs)

- The performance of an IPA depends on many issues beyond its competence;
- Lack of capacity to register all evaluation factors;
- Information is not readily available and its collection is very time consuming;
- Lack of a structured approach for data collection;
- It is not considered a priority;
- There is no standard format developed to evaluate the performance of the organization;
- Lack of sufficient funding to carry out effective evaluation, especially to engage an external professional.

Key requirements:

- Defining and stating the aims of the exercise as clearly as possible;
- Preparing the organization and its external partners for the coming evaluation by advising them of it, its aims, its expectations and the roles of those involved in the process;
- Consulting as widely as possible with those that have an interest or can provide valuable inputs; being as inclusive as possible;
- Striving for transparency with progress, methods, and ultimately findings.

The United Nations Evaluation Group (UNEG) has defined some "Norms for Evaluation in the UN System". These include impartiality, independence, transparency and contribution to knowledge-building.

Source: UNCTAD (2008b).

In order to help IPAs to better evaluate their success in attracting greenfield FDI, Loewendahl (2016b) developed the following standardized accounting method which is based around eight key areas and complements investment tracking systems (see also chapter 8, box 8.12):

1. **Company information**: company name; type (public/private); percentage foreign equity; origin country of the ultimate parent.
2. **Project details and status**: project type (new/expansion/merger and acquisition/joint venture); project status (announced/opened); description of the project.
3. **Location and sector information**: location of the investment down to site address; the International Standard Industrial Classification sector code or similar for each project, together with the business function.
4. **Investment and employment**: total capital investment and jobs to be created within three years; validation of investment and jobs over time.
5. **Qualification that announced investments will happen**: evidence from investors that their projects will happen (project information; business plan; an official press release or written declaration) and/or that the investment process has started (company registration; proof of a real estate transaction and recruitment).
6. **Evidence of IPA involvement in securing the investment**: inbound enquiry from EDO marketing activities; meeting the companies and providing business case information or an incentives package before companies announced their investments; organizing site visits for companies; providing services to help facilitate their investment.
7. **Quality of investment**: The technology level of each project using international definitions; average salary levels; identifying strategic projects that are high tech and have high levels of investment and job creation.
8. **Return on investment**: key metrics are cost per project, cost per job and the investment multiplier relative to EDO budgets. Return on investment of incentives should also be calculated.

Finally, UNCTAD's paper on evaluating IPAs is probably the most comprehensive reference and deals with tools of evaluation in more detail. The paper can be accessed at: **http://unctad.org/en/docs/diaepcb20082_en.pdf.**

In this publication, UNCTAD takes two approaches to evaluation: (a) "doing the right thing" and (b) "doing the thing right". From the first approach, the IPA is looked at in terms of its reason for being: why is it in operation? The second approach, given the rationale for its existence, evaluates if the IPA is carrying out the appropriate activities to implement its mandate and if this is being done in the best possible way. Both approaches are interlinked and inform each other but if one is successful it doesn't mean the other is too. In the end, successful evaluation requires attention to both "hard" factors such as data collection and interviewing and "soft" factors such as dealing with people and organizations to obtain their collaboration by being open, inclusive, unbiased and objective (UNCTAD, 2008b).

Collecting data and information for a successful evaluation is always a challenge. IPAs can use surveys (hard copy or online), interviews and other modalities to assess client satisfaction and obtain primary data but secondary data can be obtained from international chambers operating in a country and from investment forums and conferences and articles in international business and economic journals. Table 6.5 shows the data and information used for evaluation. Box 6.11 reviews a best practice of M&E of an IPA.

Table 6.5. Data and information used for evaluation

Type	What	Why	Examples
Stakeholder views.	Views from partners and stakeholders.	Find out to what extent the IPA contributes to policy targets, how it fits into the wider context.	Consultations with chambers of industry and commerce ministries, other IPAs, etc.
IPA views.	Views from IPA managers and staff.	Understand the development of the IPA, its strategic position, operating conditions, external partners etc.	The IPA may recently have been integrated into a larger economic development organization.
Client feedback.	Feedback from investors using IPA services.	Obtain feedback from the beneficiaries of the IPA's services.	Survey(s) of the individual(s) involved in the investment decision
Non-client feedback.	Feedback from investors that did not use the IPA.	Understand why some firms did not use the IPA.	Most questions are the same as those used in the inward investor survey.
Case studies.	Detailed studies of some representative inward investors.	Identify where the IPA can be helpful-and most helpful, and what investors value most.	Background research on the company interviews with people from the firm and others involved in the process.
Benchmarking.	Reference points against which performance can be assessed.	Compare and learn.	Study of performance and practices of national IPAs in competitor countries.
Literature, reports and documents.	Publications, etc. on subjects relevant to the IPA.	Understand changes in the environment that may influence evaluation; develop a theory of causation.	OECD, UNCTAD, World Bank publications, newsletters, reports on specific policies.
Performance-monitoring data.	Data measuring attainment of IPA objectives.	This constitutes the basis for evaluation of the IPA's performance.	Number of project successes, jobs saved or created, number of visits from firms, number of overseas presentations, etc.
Financial inputs.	The funding of activities to be evaluated.	Determine the funding of the IPA.	Other authorities than the main sponsoring department, or private organizations may contribute financially to the IPA.

Source: UNCTAD (2008b).

Box 6.11. Best practice M&E of an IPA: Business Sweden

Since 1999, Invest in Sweden Agency (ISA) and Business Sweden have been using a special follow-up system for measuring results. The overarching goal is to follow up and measure results in the form of investments and qualified inquiries in a comparatively objective manner. The system is also a control tool for ISA's operations: set criteria make it possible to measure and evaluate results in operational activities and, on the basis of this, draw up priorities for resource use.

The goals of the system are to: measure and evaluate the results of ISA's activities; calculate "return on invested capital"; compare results from various periods, countries, projects, etc.; draw up priorities for resource use; use the system as documentation for steering ISA's activities; provide documentation for external evaluation; produce documentation for funding requests (budget documentation, for example); eventually establish a national model for evaluating decisions for establishment.

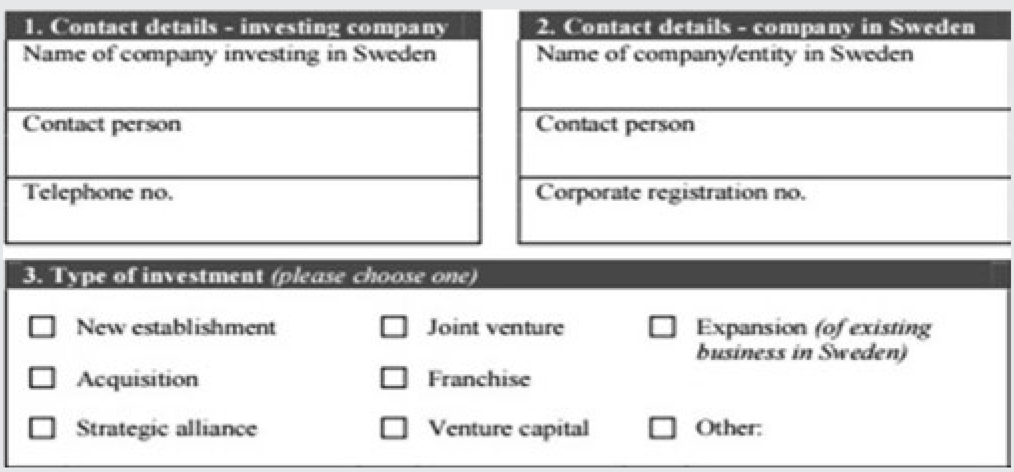
The system consists of six parts: (1) registration in the CRM system ("Salesforce") for follow-up of inquiries; (2) a filled-in questionnaire from the foreign investor; (3) evaluation by the audit committee (AC); (4) "investor perception study": yearly survey on how the investors perceive ISA's services; (5) annual follow-up of how the past three years' new establishments have developed; (6) a "scorecard."

The Salesforce registers all client contacts, both qualified inquiries "opportunities" and "leads". There is ongoing registration of contacts with companies and continuous registration, updating and classification of the various people that participate in the refinement of a given case. Foreign companies that decide to invest in Sweden are asked to fill in a questionnaire if ISA has been involved. The questionnaire constitutes two parts: a confirmation of the investment facts and a short evaluation of ISA's services and involvement (figure 6.8.).

The responsible account executive presents basic information relating to the investment and answers questions from Audit Committee members. The Committee then evaluates the *importance of the investment* and the *impact of ISA's involvement*. The importance of an investment is evaluated on a five-point scale, on which 1 is lowest and five is highest. The impact of ISA's role in the process is evaluated on a three-point scale with classifications low, medium and high.

Scorecards are produced once a year. They are special summaries for countries, focus areas and projects. The goal is to provide a summary of the connection between resources used and results and therewith draw useful conclusions.

Figure 6.8. Part of an ISA/Business Sweden investor questionnaire



1. Contact details - investing company

Name of company investing in Sweden

Contact person

Telephone no.

2. Contact details - company in Sweden

Name of company/entity in Sweden

Contact person

Corporate registration no.

3. Type of investment *(please choose one)*

☐ New establishment
☐ Joint venture
☐ Expansion *(of existing business in Sweden)*
☐ Acquisition
☐ Franchise
☐ Strategic alliance
☐ Venture capital
☐ Other:

4. Jobs at the entity in Sweden	
a) If acquisition, please indicate number of existing jobs at the acquired entity	
For any type of investment (incl. acquisition), please indicate:	
b) Number of **new** jobs created **at the time of** the investment	
c) Expected number of **new** jobs created **one year after** the investment (in total)	
d) Expected number of **new** jobs created **two years after** the investment (in total)	

5. Capital	
Approximate capital investment (SEK)	

6. Type of services provided by ISA

- ☐ Advice and counseling in the decision process.
- ☐ Information especially tailored to your needs.
- ☐ Publications/fact sheets
- ☐ Contacts with regional and local authorities, companies and others.
- ☐ Practical assistance in the actual establishment process.
- ☐ Other:

7. Quality	1 (*Poor*)	2	3	4	5	6	7	8	9	10 (*Excellent*)
Overall quality of assistance	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐
Quality of publications/fact sheets provided	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

8. ISA participation	1 (*Not at all*)	2	3	4	5	6	7	8	9	10 (*Substantially*)
To what extent did ISA contribute to your investment in Sweden?	☐	☐	☐	☐	☐	☐	☐	☐	☐	☐

Source: ICA; UNCTAD (2008b) (Annex II).

3. Using M&E results: Improving IPA services and the investment environment

M&E reports cannot be effective if the IPA does not act on the lessons learned or disseminate the findings. The overall objective behind M&E is to utilize the findings to improve the IPA's performance and enhance the local investment environment. By doing so, the IPA becomes more effective while the location would benefit from higher levels of employment, income, and an overall improvement in its socio-economic development.

There are various ways to disseminate the findings of evaluation (UNDP, 2009):

- Upload evaluation reports and other knowledge products based on evaluations on the **IPA's website**. Ensure that the reports and the knowledge products are written clearly and made available in the most commonly used languages, including English.
- Organize a **meeting with interested stakeholders**, i.e. investors, ministries, donors and sponsors and IPA staff to discuss lessons from the evaluation(s). These meetings could be held on an annual basis.
- Incorporate evaluation findings and lessons learned in the **IPA's existing publications,** such as annual reports, newsletters or bulletins.
- Develop a **brochure for the IPA's activities and accomplishments**;
- Develop a **brief with a concise summary** in a plain language and widely circulate;
- Publish an **article for an (academic, economic or business) journal** both in the country of the IPA and home country of main investors based on the evaluation findings.
- Present a **paper at a conference** related to the evaluation subject area. This could be a domestic investment forum or international investment conference such as the UNCTAD World Investment Forum or Dubai Annual Investment Meeting.

What are the main uses of the results from M&E? Four specific areas can be identified. First, M&E results can help improve the IPA's investor services. During the process of acquiring information from companies for M&E purposes, the IPA will have received direct or indirect feedback from investors about the quality of the IPA's existing services and ideas for additional services desired by investors. Some of the feedback might be applicable for setting higher performance standards for the length of time required to deliver services to investors. Also, the

results of M&E often provide insights on the appropriate number of staff members needed to carry out the services and other activities of the IPA (UNCTAD, 2008b).

The second application of M&E results is to strengthen the capacity of the IPA. Referring again to the quality of services offered by the IPA, the results offer useful information to the senior managers of the IPA in what areas staff members need additional training. The information is also relevant to performance reviews of the staff, which determine promotion and salary levels. Furthermore, if the results of M&E indicate fundamental weaknesses within the IPA, this might suggest focal areas for training of the IPA senior management.

Third, the results provide directives for setting targets and goals for the IPA's investment promotion strategy. The actual outcomes from investment strategy activities can be compared with the original targets and, if necessary, future goals can be adjusted to be more realistic (i.e., revising downwards) or more ambitious. M&E helps explain why the overall goals were or were not achieved and provide indications for future strategic or project adjustments.

The fourth, and perhaps most important, application of M&E results is to improve the local investment environment. The process of evaluation normally uncovers persistent complaints or problems encountered by investors, and these might indicate policy-level weaknesses within the country's/location's investment environment. The IPA can address some of these issues if they fall under its mandate, but beyond this, M&E results can also serve as a starting point for policy advocacy to improve the overall investment environment of a location.

Policymakers usually need convincing evidence that policy adjustments are necessary, and a rigorous process of M&E can provide precisely the kind of tangible findings that policymakers need to initiate changes. In order to do this, the Head of the IPA must present explicit findings and recommendations from evaluations to the senior government officials to help improve the competitiveness of the location's investment environment.

E. ESTABLISHING AN EFFECTIVE IPA: SUMMARY OF RECOMMENDATIONS

The following drivers and aspects of effective IPAs can be distinguished:

1. Support

It is critical that the IPA has political support and the backing of key decision-makers in both the public and private sector. This means: adequate funding, staffing and authority. Consultation with relevant stakeholders is necessary to build consensus and legitimacy.

2. Clear objectives, vision and mission

IPAs should have clear objectives, vision and mission statements. Ideally, the objectives should be linked to sustainability and reflect the four dimensions of sustainability as defined by VCC (2009).

3. Appropriate budget and skills

Most of the budget for the IPA will come from government resources. The size of the budget is important but beyond a certain size, the effectiveness of the IPA starts to go down. In other words, there is an optimum level of budget given the size of the country. Larger does not necessarily mean better results. An optimum budget would lie somewhere between $1 million and $5 million. In addition, the IPA should attract officers that have the required skills to perform the often complex tasks of investment promotion, facilitation, aftercare and others and are fully aware of investor needs and the positioning of the investor in any given sector or industry.

4. Investment and business climate

Sometimes effective IPAs can make a difference in perception and can help investors make the best of their investments but without a supporting investment climate there is relatively little the IPA can do. It is rare that an effective IPA exists in the absence of a conducive investment climate.

5. Prioritization

With limited budgets, IPAs need to prioritize those activities that yield the maximum results. Results from surveys reveal that aftercare/policy advocacy appears to have the strongest impact on FDI inflows, followed by image-building, investor servicing, and investment lead generation (UNCTAD, 2001).

6. Structure

The most effective IPAs tend to be those that are autonomous and whose chairperson reports both to a cabinet minister (or preferably, the head of government) and to a supervisory (advisory) board that includes representatives from the private sector. IPAs should be of medium and manageable size and can have subnational offices in specific regions as well as overseas in the home countries of targeted investors if the budget allows.

7. Mandate and legal authority

To be effective, an IPA must have a clear and exclusive mandate. The law should clearly outline the agency's specific responsibilities and define the required powers and legal authority so it can properly carry out its mandate. In this regard, the following questions need to be answered: (a) Will the IPA deal with investment promotion only, or in combination with trade? (b) Will the IPA deal with investment policy, facilitation, approval, etc.? Ideally, the IPA's mandate should be limited to a discrete number of tasks specifically related to increasing the inward flow of FDI and assisting both new and existing investors. Eventually, and as indicated above, investment facilitation should be a key function of the IPA.

8. Importance of policy advocacy

IPAs do have an important role in policy advocacy. Based on the feedback received from investors, IPAs can make recommendations on policies and strategies that would improve the investment climate and achieve sustainability.

9. Monitoring and evaluation

IPAs performance needs to be closely monitored and evaluated against objectives and effectiveness of activities undertaken. Benchmarks can be used to compare the IPA performance with the performance of IPAs in other countries (or regions). However, evaluation should not only be based on quantitative aspects of FDI but also the qualitative aspects, including sustainability aspects.

Annex table 6A: Self-assessment framework for strategy and organization arrangements in IPAs

Dimension	Factor	Effectiveness of current arrangements (Score of 1-5, 5 = best practice)
Policy context	Coordination with city agencies. Joint promotion with national agencies. Policy advocacy, status, visibility, and control.	
Objectives	Clear functional mandate. Agreement with respect to business planning, budget and targets.	
Sector/market strategy	Sector targeting strategy and research. Market (geographic) strategy and research. Links to wider economic development strategy.	
Organization	Coherent, effective structure of the investment promotion agency. Recruitment and development of relevant skills and people. Coordination with national and overseas stakeholders. Sales focus and customer orientation.	

Source: Based on Henry Loewendahl. *Bargaining with multinationals: the investment of Siemens and Nissan in North-East England*. (London: Palgrave, 2001), pp. 120-121; as quoted in VCC, 2009.

Annex table 6B: Self-assessment framework for marketing and investor targeting arrangements in IPAs

Dimension	Factor	Effectiveness of current arrangements (Score of 1-5, 5 = best practice)
Sector research and marketing materials	SWOT assessment of each target sector. Clear marketing theme. Marketing messages for each sector. Brochure/fact sheet for each sector Sales presentation for each sector.	
Image-building and awareness creation	High quality inward investment website Visibility and commitment of senior government officials in the city and country. Networking with investment intermediaries (brokers and international organizations). Event/trade show programme with effective planning, monitoring and evaluation.	
Investor targeting and lead generation	Company target identification and research. Contacting, prospecting, and making pitches to companies. Relationship-building with target companies. Policies to attract talent back home. Effective customer relationship management system.	

Source: Based on Henry Loewendahl. *Bargaining with multinationals: the investment of Siemens and Nissan in North-East England*. (London: Palgrave, 2001), pp. 120-121; as quoted in VCC, 2009.

Annex table 6C: Self-assessment framework for investment facilitation arrangements in IPAs

Dimension	Factor	Effectiveness of current arrangements (Score of 1-5, 5 = best practice)
Approvals	Roadmap to assist investors/one-stop shop service. Clear approval systems. Speedy and predictable approvals. FDI database systems.	
Incentives	Coherent and predictable incentives policy. Clear role and ability of the IPA to negotiate incentives.	
Project handling	Efficient project handling by the IPA Effective coordination of project handling with the national IPA and related ministries. Coordination with other city stakeholders (real estate, recruitment, suppliers, etc.). Due diligence on inquiries. Inquiry prioritization. Quality and consistency of proposals made for investors. Customer relationship management and key account management systems.	

Source: Based on Henry Loewendahl. *Bargaining with multinationals: the investment of Siemens and Nissan in North-East England*. (London: Palgrave, 2001), pp. 120-121; as quoted in VCC, 2009.

Annex table 6D: Self-assessment framework for after-care and policy advocacy arrangements in IPAs

Dimension	Factor	Effectiveness of current arrangements (Score of 1-5, 5 = best practice)
Aftercare	Priority of aftercare in FDI strategy and organization. Coherent aftercare policy and organizational delivery arrangements.	
Policy advocacy	Clear framework for policy advocacy. Supplier attraction and supplier development and linkage programme. Initiatives to increase the city's competitiveness for FDI (e.g. property, infrastructure and education initiatives).	
Monitoring and evaluation	Clear monitoring and evaluation of overall organization and FDI performance. Clear monitoring and evaluation of events and trade shows. Clear monitoring and evaluation of aftercare programme.	

Source: Based on Henry Loewendahl. *Bargaining with multinationals: the investment of Siemens and Nissan in North-East England.* (London: Palgrave, 2001), pp. 120-121; as quoted in VCC, 2009.

F. DISCUSSION ISSUES

1. Does your country/locality have an IPA? What is its role and mandate?

2. How do you rank the following roles of your IPA in order of importance: image building, investment promotion, investment targeting, aftercare, policy advocacy, investment screening, investment approvals, granting incentives, investment policy, trade policy? Which one(s) need improvement?

3. Is your IPA autonomous or part of a ministry? How independent is the IPA? Do you think the IPA has sufficient financial and human resources to undertake its assigned role?

4. What does the management and board of your IPA look like? Is it chaired by a minister or the Prime Minister?

5. Is your IPA back up by a specific law or part of a generic investment law?

6. Does your IPA have subsidiaries in the provinces/cities or do those localities have their own independent IPA? How are these IPAs coordinated?

7. What are the vision and mission statement of your IPA? If you have none, what would be an appropriate vision and mission statement? What is the specific goal or objective of the IPA?

8. Does your IPA have a client charter? If so, is this helpful? If not, should you have one?

9. What is the size of the IPA's budget? Is it big enough? If the IPA had more funds, what should it do in addition to what it already does?

10. Does the IPA undertake a planning exercise of its activities to meet its stated goals and objectives? Does it undertake regular M&A of its activities, results and impacts? If so, how can it be improved?

11. Does your IPA have overseas offices? How effective are they? Does your IPA coordinate or collaborate with IPAs in other countries, in particular those your country has an RTA with?

12. What could be done to improve the overall performance of your IPA and what criteria do you use?

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CHAPTER SEVEN

7

INVESTMENT PROMOTION AND IMAGE BUILDING

A. INVESTMENT PROMOTION STRATEGIES TO ATTRACT FOREIGN DIRECT INVESTMENT FOR DEVELOPMENT

1. The imperative of investment promotion

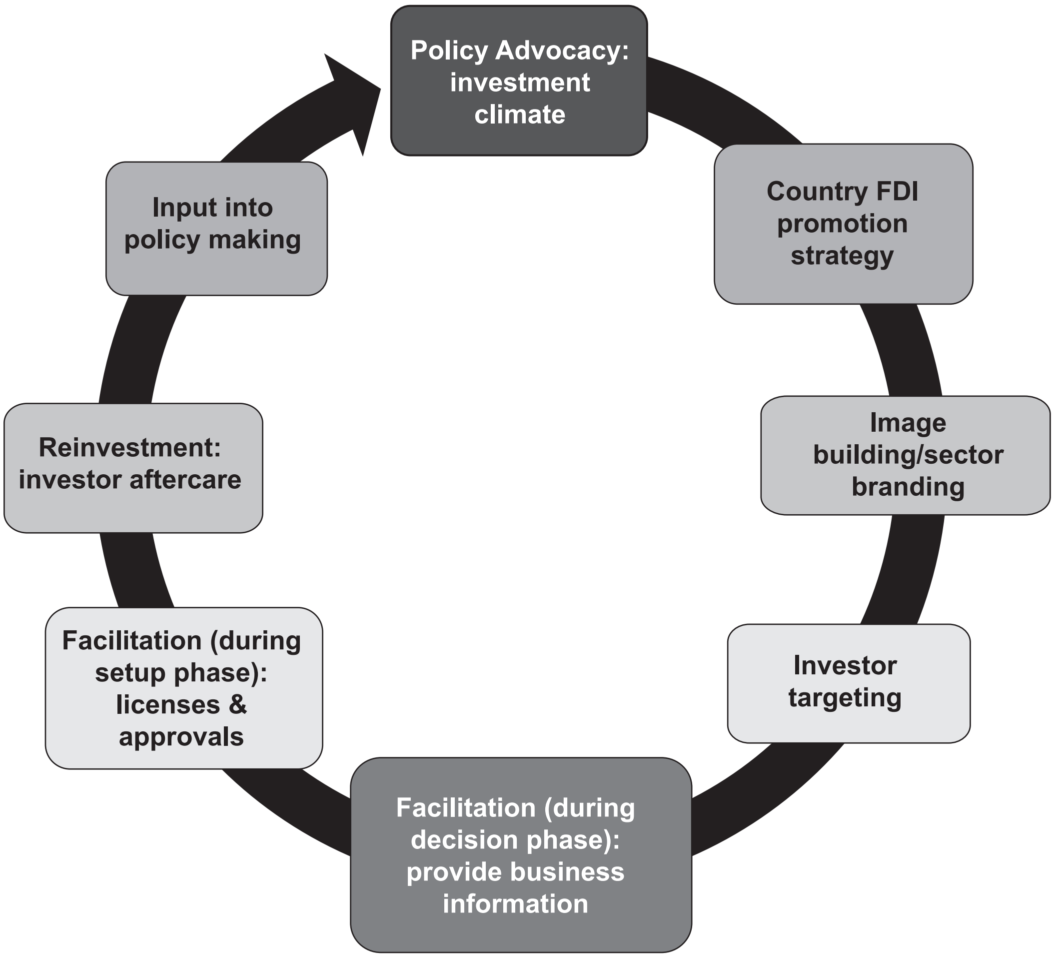
The competition among countries for attracting FDI is intensive. Once spurned as exploitative and colonialism in disguise, FDI is now aggressively pursued by most countries as it delivers, at least in theory, a convenient package of capital, skills, technology and access to foreign markets. Both theoretical and empirical evidence show that active investment promotion has played an important role in attracting larger amounts and specific types of FDI in conformity with national development plans and objectives (see e.g. Harding and Javorcik, 2007). While ongoing reforms to improve the business and investment climate remain essential, they may not be sufficient. In order to address information asymmetries, developing countries "need proactive investment promotion agencies and strategies to market their economies as sites for new FDI" (Loewendahl, 2001; Moran, 2011; Harding and Javorcik, 2012). In addition, proactive investment promotion is necessary to move from quantity FDI to quality FDI, i.e. FDI that supports sustainable development (Zanatta and others, 2006; Guimón and Filippov, 2012). According to Velde (2001), proactive and strategic FDI policy interventions affecting the dynamic pattern of national comparative advantages are required in order to avoid the risk of a low-skill, low-income trap.

World Bank studies showed that a 10% increase in an investment promotion budget leads to a 2.5% increase in FDI, while the net present value of pro-active investment promotion is almost $4 for every $1 expended.[127] The results of an analysis undertaken by Harding and Javorcik (2010) find that a dollar spent on investment promotion is found to increase FDI inflows by 189 dollars. An additional job created by a foreign affiliate requires 78 dollars in investment promotion spending. However, they also concluded that investment promotion only mattered in developing countries, not in industrialized countries.

According to UNCTAD (2001), **investment promotion** covers a wealth of services, ranging from the provision of market information to the undertaking of feasibility studies and environmental impact assessments. For the purpose of this handbook, investment promotion is defined to include only certain marketing activities through which governments try to attract FDI to a certain location/site. Promotion excludes the granting of incentives to foreign investors, the screening of FDI projects, and negotiation with foreign investors, even though many of the organizations responsible for conducting investment promotion activities may also conduct these other activities (Wells & Wint, 2001). Investment promotion covers a range of activities, including investment generation (e.g. image-building, general marketing, investor targeting), as compared to investment facilitation, which comprises aftercare services, and policy advocacy to enhance the competitiveness of a location. Indirectly, investment facilitation is part of the investment development cycle (figure 7.1). Figure 6.2 in chapter 6 also refers.

[127] Studies quoted in VCC (2009): Louis T. Wells and Alvin G. Wint, "Marketing a country: promotion as a tool for attracting foreign investment," FIAS Occasional Paper No. 1 (Washington, D.C.: Foreign Investment Advisory Service, 1990) and their 2000 update "Marketing a country: promotion as a tool for attracting foreign investment," FIAS Occasional Paper No. 13 (Washington, D.C.: Foreign Investment Advisory Service, 2000).

Figure 7.1. The investment development cycle



Source: UNCTAD (2014).

The usual institutional framework to undertake investment promotion is the investment promotion agency (IPA), discussed in chapter 6. The existence of publicly funded IPAs is motivated by *market failures*: circumstances under which the private sector is unable or unlikely to produce significant economic benefits to society. Many factors may prevent access to foreign markets, both for investors and exporters. The most important market failures that can underpin the rationale for IPAs are related to information provision (UNCTAD, 2009).

Information is not used up when consumed, and it can often be reused without losing its value. This makes it a public good. The cost of acquiring information is a fixed cost, and companies that are able to spread these costs over large sales volumes will have an advantage over firms with lower sales volumes. Companies aiming to do business in a foreign market – through FDI or export – have a great need for information. Investors need to know about suitable business partners, costs, sites, the skills available, taxes, legislation etc. Exporters need knowledge about potential importers in foreign markets, tariffs, quotas, product regulations and environmental standards. Collecting such information is often costly, and while larger firms may be able to afford it (e.g. by hiring more staff), small companies often lack the necessary resources. This market failure can be corrected if a publicly funded agency – such as an IPA – acquires the information and provides it at a low price (or free of charge). With a sufficient number of users, the benefits of providing the information will exceed the costs of acquiring it (UNCTAD, 2009). However, for the purpose of this handbook, the mere provision of information at investors' request is not investment promotion per sé but rather investment facilitation. Investment promotion refers to the active promotion of a certain location as a worthy investment destination. This means that IPAs have to reach out to investors and convince them that investing in a certain location, that investors were previously not aware about, is worthwhile. Without such promotion efforts, the investment destination would or may have been bypassed as a potential choice for the investor (box 7.1).

Box 7.1. Pro-active investment promotion: Intel in Costa Rica

Costa Rica undertook major reforms in the 1980s to improve its business and investment climate with the purpose to attract labour-intensive FDI, in particular in the textiles and garment sector. However, it was found out that mere reform, while essential, was not sufficient to be competitive as an investment destination, in particular when wages rose and international competition in textiles and garments increased. In response, the Government restructured the country's IPA, called the Coalición Costarricense de Iniciativas de Desarollo (CINDE) and gave it the mandate in 1992 to seek out more advanced FDI. CINDE discovered that reducing imperfections in information markets meant not simply supplying data that would allow investors to make international location comparisons but required more pro-active actions that put Costa Rica on the map of potential investors.

CINDE proceeded with actively targeting Intel for investment in a semiconductor fabrication plant. Cost Rica had no prior experience in this industry and therefore Intel had no information as to whether Costa Rica could match other potentially more established locations. In fact, Intel's short list included Brazil, Chile, Indonesia, Mexico and Thailand. CINDE's challenge was therefore to convince Intel to make a large capital investment in a location with no previous track record and a level of uncertainty where the value of the investment could only be assessed after the investment had been made through "trying out".

In Costa Rica, the main uncertainties were associated with fear of interruptions in production due to power cuts, slow time to market, and shortages of trained manpower. In order to address these uncertainties, Costa Rica provided a substation on the public power grid dedicated to the prospective Intel plant, renovated the national airport to facilitate rapid shipments, and directed the Ministry of Education to code-sign a vocational training programme for IT workers with Intel's human resource executives. By undertaking these measures, Intel put Costa Rica on the map of potential investment locations. With additional offers of lucrative incentives, Costa Rica tilted the decision in their favour and Intel made the investments towards the end of the 1990s.

This decision has proved to be beneficial to Costa Rica. Intel's investment resulted in significant backward linkages with domestic industry and provided a useful signal to other investors to invest in the country.

Source: Moran (2011).

As discussed in chapter 4, an important difference exists between IPAs and trade promotion offices (TPOs) in respect of their clients: while the former provide information mainly to potential foreign investors who are based overseas, the latter focus on firms operating within the country. Foreign investors need information about the investment location, while successful exporting requires that potential customers have information about the exporter's products. In this area, there are market failures that can provide a rationale for public intervention. Knowledge of a country and its companies' products may positively affect the expectations of other firms in the country and their products: there are positive externalities.

When individual companies decide to spend money on marketing, they look exclusively at the returns in terms of their own profit. Externalities are not taken into account. From the national perspective, however, these individual marketing efforts may be too small and more marketing could therefore be beneficial – not only for the individual firms, but also for the country as a whole. Having a publicly funded IPA or TPO carry out the international marketing of a country and its industries and firms could be a way to remedy this market failure. However, given the different focus and targets, the TPO function should not be combined with the IPA function in one agency (UNCTAD, 2009).

Image, brand awareness, and perceptions are major factors influencing the investment location decisions of foreign investors (IFC-FIAS, 1997). Companies make investment location decisions on the basis of their information pool and understanding of an area's location "offer". Investment promotion is therefore an essential component of attracting inward investment. The investment location information base of TNCs is far from perfect, and the decision-making process can be subjective and biased. It is often a bureaucratic process, which may be affected by imperfect competition, distorted risk perceptions, negative and often wrong perceptions of host countries, and political rivalry between affiliates of TNCs. Consequently, most companies only consider a small range of potential locations. Most locations do not even appear on their maps. Countering market imperfections in the location decision-making process is a key reason for advocating effective investment promotion.

There are some countries which have dramatically increased their FDI inflows with modest or no investment promotion at all. China is the best example supporting this fact, mainly thanks to its large market opportunities and cheap and productive labour. Indonesia is another case where significant inflows of FDI have followed policy reforms without investment promotion (Chidozie, 2014). In other words, countries that have a good

reputation, outstanding business climate and rule of law, clear competitive advantage, strategic location or other assets that attract foreign investors (e.g. the availability or large market or natural resources) tend to have less need for investment promotion though the provision of information would still be important.

Often, the misperception on the part of LDCs and other developing countries is that FDI will trigger development. Rather it is the rapid development and economic growth and associated market potential which attracts FDI (Hornberger and others, 2011; Iamsiraroj and Doucouliagos, 2015). In that case the two processes are mutually reinforcing. Without the key determinants for FDI in place, investment promotion will have little effect. However, for some small countries with no scale economy advantage, active investment promotion can make a difference as competition for FDI is fierce. Successful cases are Hong Kong, China; and Singapore, which have succeeded in attracting significant amounts of inward FDI. Obviously, these territories or countries score also very high in the quality of their business and investment climates.

2. The investment promotion strategy

As OECD (2015) states, the content of the investment promotion strategy revolves around the question of "what to promote" and depends on the balance between the country's business competitiveness and attractiveness for investment opportunities on the one hand, and the perceptions and investment intentions of investors on the other hand. An investment promotion strategy has a clear goal that conforms to the SMART criteria and outlines the activities and actions to be undertaken to achieve the goal. For instance, Kosovo developed an investment promotion strategy with the goal to "attract, retain, and grow foreign direct investment, and to attract annual FDI flows of €400 million."[128] Often, the mission, vision and goals of the investment promotion strategy are the same as that of the IPA overall, though the IPA's goals should realistically be at a higher level as an IPA not only undertakes investment promotion but also investment facilitation and policy advocacy and often other functions as well. In other words, the goal of the investment promotion strategy should specifically outline how much FDI, of what type, in what sector, and in what location (in accordance with certain quality criteria, including sustainability) should be attracted by or within a certain time period. Ideally, the goals of the investment promotion strategy should link to the country's overall investment policy goals which, in turn, link to general development goals.

A successful investment promotion strategy consists of ten components:

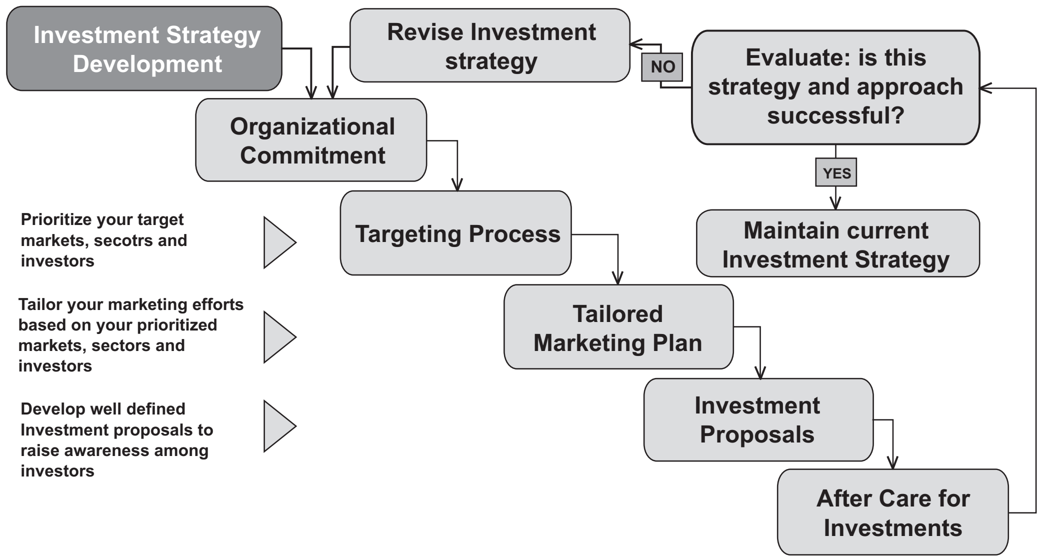
- Vision and mission statement;
- Strategic objectives;
- Benchmarking and image building;
- Markets and sector strategies;
- Marketing and promotion;
- Product development (activities to improve the local investment climate);
- Budgets and resource allocation;
- Organization of resources (organizational diagram showing each department with functions and staff members and their responsibilities;
- Key performance indicators (KPI's) for monitoring and evaluation;
- Action plan: short-term, medium-term and long-term actions required for each target and goal, outlining investment promotion tools and budgets.

Figure 7.2 shows a basic investment promotion strategy action plan template. Activities need to be undertaken at the national and international level. Some common and effective international image building and investment promotion activities include:

- Invite foreign financial media on a tour at least once in a calendar year;
- Regular interface between senior IPA officials and foreign media;
- Disseminating information and materials electronically and through mailings;
- Participation in international trade and industry fairs;

[128] Available from **http://www.invest-ks.org/repository/docs/02_Investment_Promotion_Strategy_656355.pdf**.

Figure 7.2. A basic investment promotion strategy action plan template



Source: ESCAP, International Consulting Associates.

- Appoint members from overseas chambers of commerce or other business associations as "Honorary Investment Ambassadors";
- Organization of investment road shows.

In order to achieve the goals of the investment promotion strategy, the strategy should outline general policy approaches but not dwell on them. An investment promotion strategy is not the same as an investment policy and the goals of each are at different levels. Investment policies generally aim at improving the overall investment climate while investment promotion strategies have more quantifiable goals referring to the amount of FDI the location aims to attract by a certain time limit. In other words, an investment promotion strategy does not cover policies but rather looks at concrete modalities and tools to promote, attract (and facilitate) FDI. These tools are further explored in the next subsection.

Research has shown that IPAs that actively prioritize and target sectors attract more FDI than those IPAs that do not target specific sectors. IPAs require sector knowledge to generate information of high value to investors, but it is a complex matter for any IPA to be an expert in all sectors. It is therefore essential to examine and identify a few sectors of strategic value to national development and prioritize those. In practice, it appears that IPAs indeed tend to articulate a list of priority sectors, but in practice have done little to accumulate sector-specific knowledge and staff expertise, or even to ensure that all priority inquiries receive replies. Tourism and agriculture are the most frequently targeted priority sectors (UNCTAD, 2007). Investor targeting is discussed in more detail below.

A primary reason for IPA failures is a shortage of expertise and information, despite the fact that most public IPAs potentially have institutional access to much of the information needed by potential investors (World Bank, 2016). Governments generate data and analysis on labour, infrastructure, transport, taxes, laws and regulations, and other crucial business-environment factors, which are not provided by the private sector, either because the private sector does not have access to the same sources as governments or because it finds no benefits in doing so. Most public IPAs only have to identify the information needed by potential investors, establish connections with the government sources of that information (which are usually encouraged if not mandated by public policy), periodically collect up-to-date information, and present it in a way that is comprehensive, accessible with a minimum of effort, and promotionally effective. For instance, a good IPA website consists of per-priority industry information, including a promotional video, a sector profile, industry news, fact sheets, and testimonials from satisfied investors in that sector. As mentioned before, it can be a tough decision, but deciding on what sectors to focus the limited resources of an IPA is the first step in successfully promoting them. Nearly without exception, successful IPAs have targeted particular priority sectors and prominently displayed them on their websites. Although high-quality IPAs respond to every inquiry, one of the most widely shared characteristics among top IPAs is that they have identified a few priority sectors on which to focus the bulk of their promotion and facilitation efforts. This approach is essential in enabling the creation of the in-depth business knowledge needed to comprehend and meet the needs of specific investors.

B. INVESTOR PERCEPTION AND IMAGE BUILDING

1. Investor perception

Research by ICA has revealed that over 70% of all clients of site-location consultancies put together a short list of location options identified before the site selection professional is even contacted. This short list is often based on decision-makers personal perceptions. Investors will typically review locations (VCC, 2009):

- They have invested in before;
- Their competitors have already invested in;
- Major customers or suppliers have a presence in;
- Appear in location attractiveness rankings;
- They have read positive reports about in the business press and media;
- They have visited on business trips or even on vacation;
- They have family roots in.

Even when investors are aware of certain locations, their perceptions may be either right or wrong but rarely accurate. When Viet Nam began its policy of Doi Moi or economic liberalization programme in 1986 FDI did not immediately pour in. The country had a lot of work to do to convince investors it was no longer at war, despite the fact that the war had ended almost ten years earlier. The negative perceptions of Viet Nam as a war country did persist well into the 1990s. **Communication is therefore as strategic as the product itself or the targeting.** Selecting the right communication tools, so as to be able to send out the right messages during the right time (marketing mix) is an essential prerequisite before starting a promotion campaign. Negative bias caused or reinforced by mismanaged communication can be indeed more detrimental to a location's attractiveness than a total absence of visibility. The first step of an investment promotion programme is therefore **image building**: the communication of the true characteristics of a host country/location that matter to investors. Image building may include **positive reinforcement** of investor perceptions or **removal/correction of negative bias** based on wrong investor perceptions of a location (Loewendahl, 2001; Fan, 2010).

In order to establish the key elements of an image-building strategy, it is necessary to first identify what potential investors think about a location. Investor perceptions can be measured in a variety of ways (World Bank, 2016):

- **Publicly available reports** on a location and its investment climate. A variety of organizations produce these reports, including multilateral institutions and both governmental and non-governmental sources. Such organizations include the World Bank, UNCTAD (World Investment Report), and investment guides developed by private consulting firms.
- Performing **online searches via the Internet** of the archives of leading newspapers and specialized reports/magazines/periodicals. By examining online country reports and news articles it will become clear how influential government and media sources commonly portray a country. These portrayals frequently shape investors' general perceptions of a location and will likely vary from sector to sector. If a location already receives investment from a particular sector, investors from this sector are more likely than not to have better than average information on a location. The converse is also true.
- Performing **surveys and questionnaires** on the perceptions among existing and potential investors. Whether the target audience is from sectors already investing in a country or not, it is essentially to know how it perceives specific aspects of a location (World Bank/MIGA, 2000b, 2003).

Investor perception surveys should be brief as investors are usually weary to fill out questionnaires, in particular if these are long and cumbersome. The target audience should be large enough (e.g., 500 firms) to yield a sufficient quantity of responses, as only 5-15% of recipients are likely to respond. The target audience should consist of firms in countries and sectors that are most likely to find the location attractive. Agencies that do not have an internal database can purchase company records from firms specializing in the collection and sale of company data, which is relatively inexpensive (World Bank/MIGA, 2000b, 2003).

Figure 7.3 shows an example of such a survey. Information retrieved from surveys or questionnaires will tell the IPA what steps are required to be taken to bridge the gap between how the target audience views a location and how the local authorities would like the location to be perceived in the future. This market research is integral to designing an effective image-building strategy and to determining the central marketing theme of an image-building campaign (World Bank, 2016). If the survey recipients have negative perceptions of some location factors that have recently improved, this information will help local authorities to pinpoint a focus for an image-building campaign.

Figure 7.3. Sample investor perception survey

PLEASE RANK YOUR PERCEPTION OF THE FOLLOWING FACTORS

On a scale of 1 to 6 using the following scale:

1. Very unfavourable
2. Unfavourable
3. Acceptable
4. Favourable
5. Very favourable
6. Don't know or no opinion

	1	2	3	4	5	6
Political situation	☐	☐	☐	☐	☐	☐
Economic situation	☐	☐	☐	☐	☐	☐
Attitude of government towards attracting FDI	☐	☐	☐	☐	☐	☐
Market accessibility and distribution	☐	☐	☐	☐	☐	☐
Ability to recruit a productive workforce	☐	☐	☐	☐	☐	☐
Overhead costs	☐	☐	☐	☐	☐	☐
Incentive regime	☐	☐	☐	☐	☐	☐
Telecommunications Infrastructure	☐	☐	☐	☐	☐	☐
Taxation regime and profit repatriation	☐	☐	☐	☐	☐	☐
Sourcing and subcontracting opportunities	☐	☐	☐	☐	☐	☐
Business establishment procedures	☐	☐	☐	☐	☐	☐
Country track record in attracting FDI	☐	☐	☐	☐	☐	☐
Overall investment climate	☐	☐	☐	☐	☐	☐

Source: World Bank/MIGA (2003). Available from **https://www.wbginvestmentclimate.org/toolkits/investment-generation-toolkit/**

Survey results also can indicate whether local governments, in fact, should commence an image-building campaign. For example, results may show that investors have an unfavourable perception of the location's political and/or economic stability. If a location has an unstable political and economic climate, it would be premature to run the image-building campaign until positive changes in the investment climate have occurred (World Bank, 2016). In such cases, the appropriate response is for the IPA to bring these factors to the attention of the government so that the identified obstacles can be eliminated. Where a country has a relatively stable and conducive investment climate, the survey can pinpoint particular investor issues the IPA was not aware of. Similar surveys can also be used as a monitoring and evaluation tool of the IPA's performance. Box 7.2 shows the results of a similar survey done for Thailand's Board of Investment in 2015.

Finally, the findings of the questionnaire can have budgetary implications for the IPA. There is no set answer as to how long an image-building campaign should run, but if existing perceptions are negative, a campaign's central message should counter this image with tangible evidence that the situation is improving or has improved. In such cases, an image-building campaign can run for several years, and should therefore be incorporated into the IPA's multi-year budget (World Bank, 2016).

Box 7.2. Results of investor perception survey: Thailand

Thailand's Board of Investment conducts an annual "Foreign Investors' Confidence in Thailand" survey, conducted by a private consultancy firm, Bolliger & Company Ltd. (Thailand). The results for 2015 were published in a report submitted in September of that year to BOI.

To gather the information required, a questionnaire was sent to 3,000 foreign companies located in Thailand. Selected companies were restricted to having foreign shareholding of at least 20% and included both BOI-promoted and non-BOI-promoted companies. Of 3,000 companies, 600 replied (a response rate of 20%). Bolliger & Company (Thailand) Ltd. also conducted in-depth interviews with 25 out of 600 companies so as to gain additional information, comments, and suggestions. Of the 600 companies that completed the questionnaire, 99% were promoted by the BOI while 1% was not. The majority of these companies were Japanese (56%). Categorizing by industry, investors in metal products, machinery and transportation industry made up the largest proportion of respondents (32%). In terms of size, 25.50% of respondents were small companies having assets of about 0-50 million baht, while 25.33% were large companies with assets of over 500 million baht. As for employment, 31.33% employed between 1 to 50 employees and 82.00% employed foreign employees in the proportion of no more than 10%. It is interesting to learn that most companies (68%) received income from both domestic and international markets.

The survey found that, for 2015-2016, most foreign investors planned to maintain or increase their investment level in Thailand. To be more specific, 73% intended to maintain investment level while 25% intended to expand their investment level. To estimate foreign investors' confidence level, a Business Sentiment Index (BSI Index) was calculated around six indicators: (a) total revenue; (b) domestic sales; (c) international sales; (d) profits; (e) liability; and (f) total investment. If the BSI is equal to 50, then foreign investment confidence remains unchanged from the previous period. If the BSI is greater than 50, then foreign investment confidence has improved from the previous period. If the BSI is less than 50.00, then foreign investment confidence has worsened from the previous period. For 2015, the BSI showed an overall value of higher than 50 and was only lower for the indicator of liability.

Most foreign investors considered the investment climate in Thailand to be positive and the factors that were most supportive for the year 2015 were: (a) availability of suppliers; (b) availability of raw materials/parts; (c) overall infrastructure; (d) privileges from Free Trade Agreements (FTAs); and (e) transportation and logistics systems. Comparing the results of 2015 with those of 2014, it appears that the scores of almost all supportive investment factors were greater in 2015 than in 2014, except stability of the domestic economy, and transportation and logistics systems.

Source: Bolliger & Company (Thailand) Ltd., 2015: 2015 Foreign Investor Confidence Survey (September). **http://www.boi.go.th/upload/Foreign_Investor_Confidence_Survey_(EN)_85544.pdf**.

2. Image building

(a) *Fundamentals of image building*

An image building campaign is often a first step of an investment promotion strategy. The investor perception study is the first important stage in developing an image building and investment promotion strategy. Effective IPAs should react to complaints of existing investors and advocate changes that lead them to reinvest and spread a positive image of the country's investment climate. Consequently, the next stage is to define the brand image of the country and conduct a professional benchmarking with competitor locations for each target sector/activity in order to develop the compelling sales messages and proposition-based marketing materials and tools (UNCTAD, 2008).

IPAs need to adopt a strategic approach over time to improve the image of the country/area vis-à-vis other locales for investment, by facilitating investment at all stages, servicing investors, and acting as an effective intermediary in all relevant areas. Image building is a foundation block in the process of attracting FDI. Its role is primarily that of focusing investor interest on the location and overcoming negative perceptions rather than directly persuading a TNC to invest.

Image building is particularly important for countries which are new to investment attraction and are undergoing rapid political and/or economic reform, or those which have faced violence or terrorist acts (directed either to themselves or to neighbouring countries). It is equally important for small countries which receive little international media coverage. Image building may require considerable and well-targeted expenditure over time, but in itself is not sufficient to make an investor decide on a particular country or location as investment destination (Asfour and Declan, 2005). At the image building stage, the basic tools of marketing are applied to promote the country/area usually for the general investor but also for targeted investors. Techniques include

segmenting markets, direct marketing, telemarketing, investment exhibitions, missions and seminars, and direct selling, where individual companies represent a key target audience.

For direct selling, a more targeted approach is needed, based on the business needs of the investor. This can be a long-term process, requiring regular contact over several years before the IPA and the country are automatically in the investor's mind when reviewing new business strategies and making investment location decisions. To make this approach work in reality, the IPA has to build and maintain a presence in its key geographical markets, focusing on those companies looking for particular advantages offered by the IPA's country and maintaining regular personal contact with key decision-makers (World Bank, 2016).

(b) Eight basic steps of image building

Many IPAs have never developed and launched an image building strategy and therefore might be unsure of how to go about it. Eight simplified steps are offered here to assist the IPA in preparing an image building strategy.

Step 1: Prepare for successful image building by ensuring that the necessary information is available, senior officials within and outside of the IPA are committed to image building, and that the IPAs staff have the required competency to undertake all parts of the image building campaign.

Step 2: Define the target audiences for the image building campaign, including existing and prospective investors, people who influence public opinion, and other targets.

Step 3: Clearly define the content of the image building message. Such a message should contain a **Unique Selling Proposition or Point** (USP): a statement that contains a characteristic that sets the location to be promoted apart from the competition as an investment location. The USP is developed on the basis of a SWOT analysis and should be accurate and truthful. The USP should inspire investors and make them confident about the location's superior attractions (World Bank/MIGA, 2000b). See box 7.3 for some examples of outstanding USPs. If the location is not able to develop a meaningful USP, it should develop a phrase that clearly spells out advantages for investors to invest in the location even though there are other locations with equal competitive advantage.

Step 4: Set clear goals and priorities for the image building campaign, such as overcoming particular negative images or creating awareness about new or little-known positive features of your location. Assess the priority attached to each objective and consider dropping or seeking to drop goals/objectives with low priorities. Set the targets, including interim targets with clear time frames, in relation to each goal/objective, as such targets enable monitoring and motivate team members. Ensure that the marketing theme fits the goals.

Step 5: Identify and develop the main strategic activities for conveying the message to the target audiences. Some key elements of an image building strategy are: (a) marketing theme: USP; (b) target messages and promotion materials to investors; (c) continually develop and update public relations materials; (d) use a broad spectrum of media to convey the message; (e) build and develop media contacts; (f) work to position the local IPA as the best source of information (credibility building) for the media on investment-related issues; (g) work to position the head of the local IPA as a regular spokesperson for the organization.

Step 6: Before launching the campaign, coordinate with the people involved and possible partners to ensure there are no conflicting commitments or overlapping programmes and activities, and that there is adequate time to execute the campaign. Two major mistakes in public relations programming are: (a) not knowing what others have planned; (b) not allowing adequate time to execute your plan.

Step 7: Communicate with the team members and other stakeholders throughout the planning and implementation stages.

Step 8: Prepare a written plan with clear deadlines and allocation of tasks for consideration by the IPA's Advisory Board or Board of Directors. A detailed project plan helps to communicate objectives, resource requirements, schedules, and milestones. Such a plan should:

- Ensure that the estimates of timelines and budgets are realistic;
- Ensure that planning and communication include checking on the timing and availability of the required inputs and resources;

- Identify the critical success factors;
- Identify the likely barriers to success: skills not available, information not available, current work load too high.

When committing resources, the requirements should be estimated carefully, e.g. in terms of:

- How many people are needed- what will each person do?
- What type of skills and at what level do these tasks require?
- What facilities, materials, etc. are required for each activity?
- What IT support is needed?
- What overall costs are involved – can the estimates be justified?
- If outside resources are needed, can these be purchased or contracted?

Box 7.3. Examples of Unique Selling Propositions for image building purposes

A good USP is a statement of how a certain location or service:

- Solves a problem;
- Improves a current situation;
- Delivers a benefit;
- Stands out from other locations.

Good USPs are rare as no location is really unique and while some IPAs use catchy general phrases they rarely explain why something is really unique to the location to be promoted. When Ireland developed an industrial cluster programme to encourage FDI in software development industry in the mid-1980s, its IPA – the Irish Development Authority – ran an extensive awareness campaign in support for the programme using the phrase: “Young Europeans – hire them before they hire you.” (World Bank/MIGA, 2000b).

The city of Madrid has a website presenting its USP in terms of a rather lengthy overview of the city’s advantages and attractions (**http://www.investinmadrid.com/index.php/business-location-madrid/unique-selling-proposition/112-unique-selling-proposition**). However, while such an overview is important and part of the SWOT analysis, it is not a USP. A USP should be a brief marketing slogan that reflects something unique about the investment location.

The IPA in Macedonia – Agency for Foreign Investments and Export Promotion – has a simple USP that, though perhaps not unique, at least immediately shows the country’s marketed advantage as a low-cost investment location: “Need to cut costs? Invest in Macedonia?” (**http://www.investinmacedonia.com**).

While not meant to attract FDI but rather international tourists, Malaysia launched a worldwide marketing campaign called “Malaysia, Truly Asia” in 1999 which was largely successful and brought in over 7.4 million tourists. The slogan was not only catchy but also truthful reflective of the country’s multi-ethnic population.

The Malaysian Investment Development Authority (MIDA) has the following USP: “Invest in Malaysia: Your Profit Centre in Asia.” (**http://www.mida.gov.my/home**). The USP is good as it informs investors of potential profit opportunities without claiming that the country is the best profit centre. In this respect, it is at least truthful and not overambitious.

Sri Lanka’s Board of Investment uses the following slogan: “Sri Lanka: the Wonder of Asia.” (**http://www.investsrilanka.com**). While it is a nice slogan it does not show any unique competitive advantage of Sri Lanka as an investment location and may appeal more to tourists than to investors who may wonder what the “wonder” is all about.

The website of the IPA in Austria (ABA) uses the slogan: “Austria: where your profits grow sky high.” While seemingly attractive as a slogan the USP does not really inform investors why their profits would grow sky high in Austria and not somewhere else. A good USP should address that issue rather than present a general somewhat cliché slogan (**http://investinaustria.at/en**).

Source: Websites mentioned in text.

(c) *Image building tools*

Image building tools are basically information tools which are also used for active investment promotion and targeting. They include:

- **News releases; features and articles**: such releases and articles are not always guaranteed to be placed in well-established newspapers and relevant business journals and give very little editorial control by the IPA. In addition, in order for such a release to be effective, it should be placed repeatedly containing a persistent message.
- **Introductory brochures**: well designed, brief to the point information, accurate and truthful; summary of expected services for investors. The brochure should convincingly answer the question: why should an investor invest in this location?
- **Fact sheets**: a brief and simple list of data of relevance to the investor, including general economic and industrial data, trade statistics, indicators of investment climate, incentives, labour and skills availability, principal laws and regulations, taxation, costs of doing business, quality of life, role and services provided by the IPA. Testimonials from existing investors can also be included.
- **Website and social media**: brochures and fact sheets can be published on the IPA's website and social media such as LinkedIn and Facebook (see below on the role of websites and social media in investment promotion).
- **Promotional video**: relatively expensive and will be outdated quickly. Video should be brief, to the point and focused. Should be interesting to watch and not have any lengthy statements by politicians about how wonderful the country is (box 7.4).
- **Advertising campaigns**: to be conducted in investor home countries to a targeted audience but this can be expensive. Such campaigns should be run in relevant journals and newspapers and can also be in the form of brief commercials on major television channels. Often, advertising campaigns lack credibility and should contain testimonials from established investors with international reputation. A specialized advertising/public relation firm can be recruited for this purpose if the IPAs budget allows.
- **Infomercials for TV**: such campaigns can be effective if repeatedly shown. However, they are very costly in terms of development and placement but give the IPA total control of what should be contained in the infomercial.
- **Promotional conferences, fairs, seminars and roadshows**: aimed at targeted audience. Should be well prepared with high quality speakers, including established investors who can act as ambassador for the location. It is important to ensure high press coverage of the events. Large fairs should only be conducted after the development of a specific sector or launch of an image building campaign and are probably better as an investment promotion tool than as an image building tool.

Box 7.4. Key requirements for a good promotional video

(1) Keep it short, four or five minutes is the maximum length.

(2) Keep it focused; consistently tell viewers why they should invest in your location.

(3) Footage should include tape that can be used in a brief "video clip" for a CD-ROM and the IPA's website.

(4) Keep costs down by using a local film crew.

(5) Try to create a video that will last for 18 months to 2 years; for example, while video footage of prominent politicians can be useful from a promotional perspective, a change of minister will immediately make the video obsolete.

(6) Use extensive graphics and captions, which increase the amount of information that the viewer can absorb in a short amount of time.

(7) Produce different-language versions of the same video if you plan for them from the start.

(8) Produce a video that reflects the marketing messages and themes identified when developing your communications strategy.

Source: World Bank/MIGA (2000b).

Other tools are newsletters and sector studies that are perhaps more useful as active investment promotion tools. Some of these tools, in particular the website, are reviewed in more detail in the next section.

IPAs need to prepare a basic **investor package** that contains information the investor cannot do without. Such a package should contain, at a minimum:

- Investment promotion “pamphlet” and guide to doing business;
- Fact sheets;
- The unique selling propositions about your location (to convince investors to locate there);
- Investment “opportunity profiles”;
- Costs of doing business;
- Latest issues of newsletters (if any);
- Other relevant information.

An **investment opportunity profile** should contain the characteristics of a given sector open to investment promotion and the opportunities for investment, including information on potential business partners and available facilities. It should be accompanied by a fact sheet containing key facts and figures of both location and sector.

C. PROMOTING LOCATIONS AND SITES FOR FOREIGN DIRECT INVESTMENT

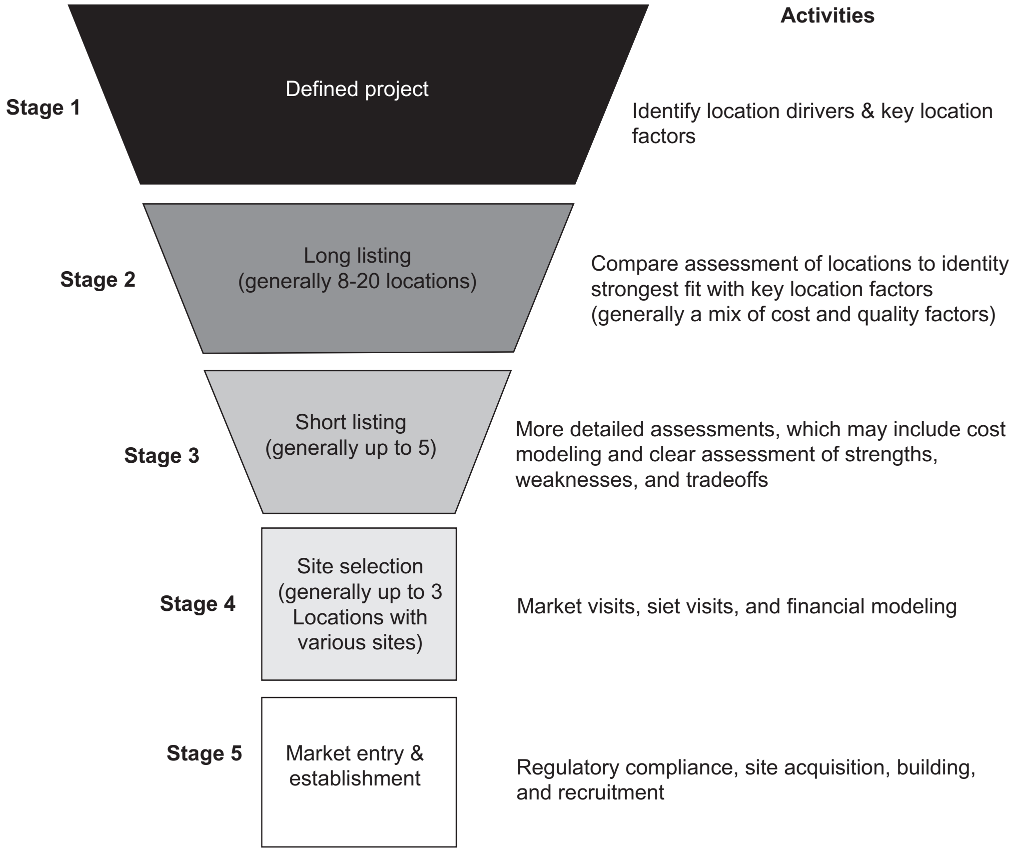
1. The corporate site selection process

The most fundamental aspect of investment promotion is to convince a particular targeted investor to invest in a particular location whether this is the country as a whole, a city, an SEZ or any other location. Therefore, investment promotion is, to a large extent, similar to promoting a particular location for investment. This starts with image building, which is essentially building a positive image of a certain location. In order to develop a meaningful image building and investment promotion strategy, IPAs need to have a realistic understanding of the competitive position of the promoted location vis-á-vis other locations in other countries. This involves a comprehensive benchmarking exercise which should result in a solid **location value proposition** (LVP). In order to do a meaningful benchmarking and development of a LVP, IPAs need to know the factors and considerations that investors use in selecting their sites for investment (figure 7.4). In other words, knowing investor needs and requirements and what investors look for in sites is fundamental in presenting an attractive LPV which can convince investors that the promoted location/site is the best option available.

Corporate investors (or rather the professional location advisers and site selection consultancies) use models to evaluate the competitiveness of locations and to calculate the return on investment. More specifically, five phases of a typical corporate site selection process can be identified as shown in figure 7.5. These five phases can also be used by IPAs to mirror the corporate site selection decision-making process for their own benchmarking exercise and anticipate investor needs.

- **Strategic assessment:** In the initial phase, important questions such as where and how to invest and what functions will be part of the investment scope, are addressed. What are the corporate objectives (i.e. market seeking or efficiency seeking) and when should the new business entity be operational? What are the most important location factors and how should these be prioritized? Companies will do a strategic assessment of investment locations based on considerations such as costs, availability of labour, ease of doing business, infrastructure and other determinants depending on the type of investment (chapter 1). Often, the presence of foreign investors in a certain location can also be an important determinant (Mukim and Nunnenkamp, 2010).
- **Location screening, modelling & benchmarking:** In the second phase, all location specific data will be collected by means of desk research and actively reaching out to recruiters, brokers, universities, and other service providers. All locations are evaluated, benchmarked and ranked by using different benchmarking techniques. In this phase, the level of research normally starts at country level, but soon focuses on a region within a country or city.
- **Cost comparison:** In the third phase, a comprehensive financial cost model investigates the operational cost and investment expenditures associated with a specific location. A financial cost model provides for a method to systematically calculate the expected return on investment by using a ten-year

Figure 7.4. The investor's process for site selection*



Source: World Bank Group/MIGA (2006); figure 1.

**Note*: The site selection process is increasingly being outsourced by investors to professional location advisers and site selection consultancy companies.

net present value technique. All elements of the internal and external business environment will be incorporated.

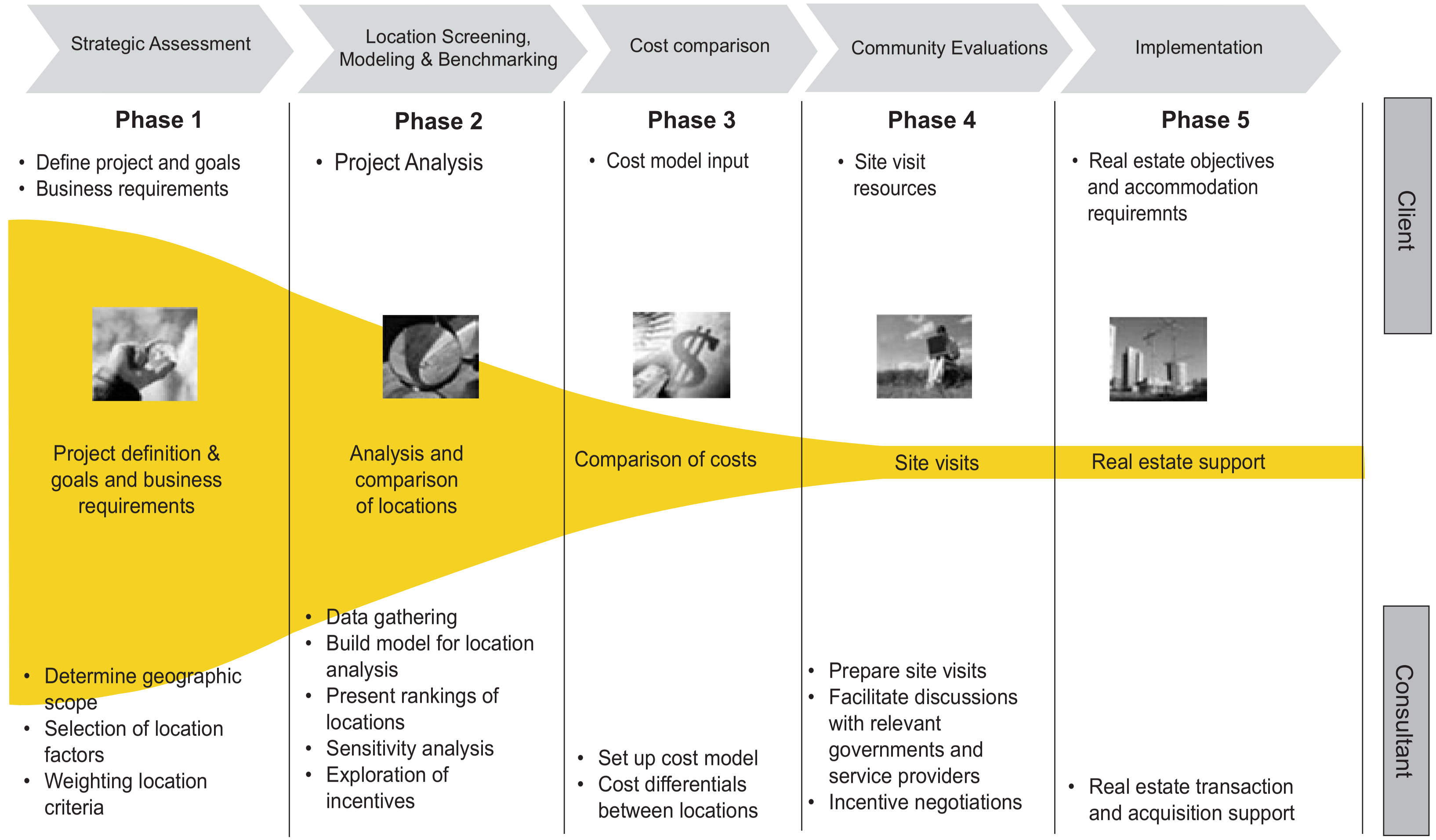
- **Site visits:** When the decision-making process is in the final phases, it is essential to investigate the location and the proposed (industrial) site. Typically in this phase, meetings with IPA officials are scheduled, as well as with zone operators, local government officials, accounting and legal experts and recruiters. One important aspect during this phase is to validate the incentive potential and to assess the existence of additional (local) incentives. This is a crucial aspect of investment facilitation for the IPA.
- **Real estate solutions:** In the fifth and final phase, a favourable real estate solution or land proposition is negotiated with the landlord or concerned governmental department in the host location.

(d) Phase 1: Strategic assessment

For the company, a strategic assessment of the required contribution of the planned investment project within the overall business strategy and goals will take place. For the IPA, a strategic assessment of the company's investment project is also normally the first step. This phase consists of defining the investment project's scope and goals as well as the requirements for the investment. In other words, investors need to have a general idea of the **capability factors** and various **cost factors** in the host country. Capability factors can be divided into two categories: natural endowments and developed resources (table 7.1).

The combination of capability and cost factors are often referred to as **business factors**. This phase of the site selection process is focused on creating a complete overview of the proposed investment project, its activities and its implications which are translated into a complete list with prioritized location criteria based on business factors. The objective of this phase is to translate the business requirements into a complete set of prioritized location factors and prioritized benchmark criteria.

Figure 7.5. The investor location decision-making framework



Source: Investment Consulting Associates.

Table 7.1. Capability factors – divided in natural endowments and developed resources

Natural endowments	Developed resources
Access to abundant water supplies;	Airports and seaports;
Climate;	Human resources;
Raw materials and minerals;	Universities – Education;
Sea access;	Roads;
Bordering neighbouring countries;	Telecom infrastructure;
Population;	Industrial sites and free zones;
Cities;	Legal framework;
Ancient cultural treasuries.	Market opportunities.

Source: Investment Consulting Associates.

The following questions should be answered in this phase:

- **What are the company's short- and long-term goals and its policies to achieve them?** Of all location criteria, some are specific to industry groups (i.e. automotive, services, manufacturing), whereas some relates to geography and/or timing of the project. There are also decisive criteria associated with either the company policy or personality factors. Thus, company's strategies and policies determine locational decisions and understanding the process and decision- making process within the company are of significant value.
- **What are the main requirements of the investment project?** The purpose of answering this question is associated with evaluating and calculating all factors that might affect the locational decision. This information is often obtained through questionnaires with respect to objectives, (current) sites and buildings, financial assumptions, value chain, (human) resources, utilities and ecology (i.e. serve as input for phase 3).

As explained in chapter 1, one way of looking at the motivation factors is to distinguish between two sets of determinants: first, the firm or industry-specific determinants which essentially influence the initial decision to undertake an investment outside the home country; and second, the host country- or location-specific determinants which influence the decision on the final destination of the investment. The importance of these two groups of factors varies strongly by company size; market orientation (domestic versus export); industry sub-sector; and investor nationality. IPAs need to understand the firm-specific determinants and can influence location-specific determinants to meet investor needs.

(c) Phase 2: Location screening, modelling & benchmarking

For the investor, locations are identified and compared on the basis of various criteria used in the strategic assessment, in particular costs (see phase 3). They may contact the IPA for inputs for this exercise. For the IPA therefore, the purpose of this phase is twofold: first, to analyse the host country's/location's competitive position in the global landscape for FDI and secondly, to evaluate and compare potential locations through data gathering and location modelling based on the list of criteria developed in phase 1. Therefore, this phase basically consists of two sub-phases:

- Analyse local, regional and global FDI trends; and
- Conduct location benchmark analysis based on a defined list of location criteria

Conducting research on FDI trends with respect to destination, sources and sectors enables the IPA to position the competitiveness of the host country in the global FDI arena. This analysis provides information on whether the specific sector and business activity is in line with current investment trends. It also shows the investment trends of similar companies in the same sector. The point of departure for this quantitative FDI assessment is to start with a global FDI scan showing aggregated FDI trends. Increasingly, the analysis will focus on assessing the FDI market position and segmentizing promising sectors and business activities that might meet the competitiveness level of the host country or might actually contribute to improving it.

For different geographical levels (for instance world, Asia, South-East Asia, country, province, city or EPZ) the IPA has to conduct the following FDI assessments:

- Source market FDI assessment – Where is the FDI coming from?
- Destination market FDI assessment – Where are the FDI hotspots?
- Sector and sub-sector FDI assessment.
- Business activity FDI assessment.
- Identify key motives and location determinants for a particular investment.

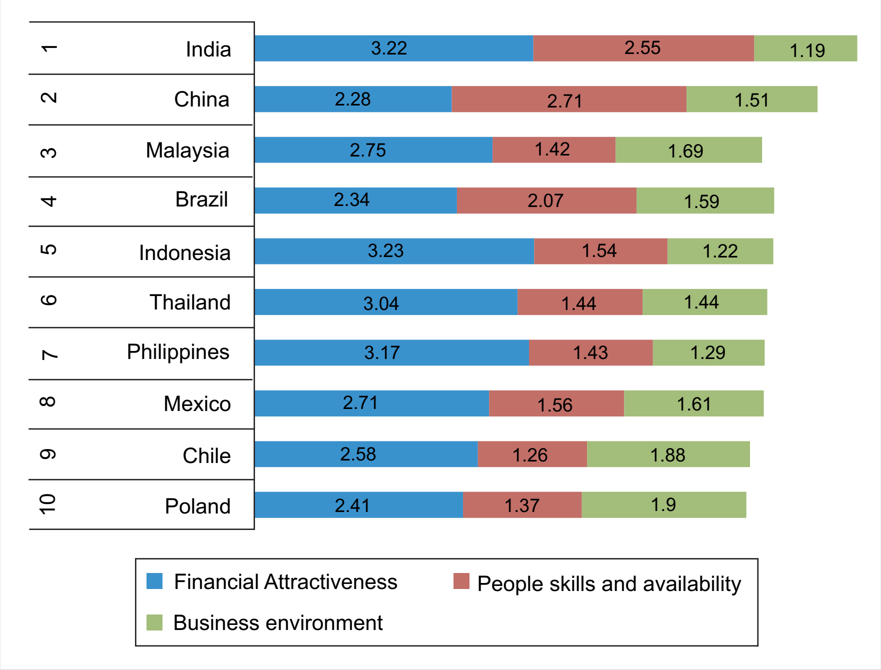
With respect to the location benchmark analysis, it is important to effectively translate the project definition undertaken in phase 1 into actual benchmarking factors. There are different calculation techniques to do so, and below are the three most commonly used:

- **Benchmark module**: Evaluate, benchmark and rank the competitiveness of countries and cities by selecting a wide variety of location factors (box 7.5).
- **Weighted analysis module**: Use multiple criteria and a custom weighted analysis to benchmark the competitiveness of locations given the specific needs of the host country/location.
- **Cost – Benefit module:** Benchmark and rank countries and cities in accordance with their cost-benefit capabilities to further identify and verify the overall investment climate.

Box 7.5. A.T. Kearney Global Services Location Index (GSLI)

The GSLI (maximum score: 10) tracks the contours of the offshoring landscape in 55 countries across three major categories: financial attractiveness (40%), people skills and availability (30%), and business environment (30%). Financial attractiveness includes assessment of cost of compensation, infrastructure, and tax and regulatory. People skill and availability includes cumulative services experience and skills, labour force availability, educational skills, and language skills. Business environment includes four dimensions: country risk, cultural adaptability, country infrastructure, and security of intellectual property. Figure 7.6 shows the top 10 countries in the 2016 index. In addition to GSLI, there are other studies which also benchmark the attractiveness of a given country/region, such as the World Bank's Ease of Doing Business Rank (see chapter 3).

Figure 7.6. 2016 A.T. Kearney Global Services Location Index top 10



Source: A.T. Kearney (2016).

Before conducting the benchmarking analysis, appropriate data should be verified and cross-checked with other available sources. Moreover, locational factors should be weighted. The weighting process is to a certain extent arbitrary, but must reflect reality as much as possible. For instance, if labour costs represent 60% of the annual operating cost, then this factor should be prioritized accordingly.

The outcome of this phase is a clear and detailed overview of the current local, regional and global FDI trends, sources and destinations that might be relevant to the company's project definition. In addition, this phase provides an evaluation and a ranking of potential locations based on the project definition (as defined in the first phase) summarized in a thorough fact-based benchmark report. The IPA will be in a better position to benchmark the location than the investor as it has access to primary and up-to-date data not readily available to the investor. The role of the IPA is to bring the location to the attention to the investor, gain the investor's interest, and then work with the investor to provide the information needed and market the location on the basis of true parameters.

(c) Phase 3: Cost comparisons

For the investor, activities within this phase include the development of cost models and calculation of cost differentials between locations taking into account investment volumes, annual operating costs, fiscal and depreciation methods, as well as existing incentive regimes. The benchmark analysis includes as assessment of cost factors such as:

- Wages and salary costs, productivity levels, education level;
- Land and real estate costs and the quality of real estate;
- Costs of utilities: power (gas and electricity) and reliability of supply and network;
- Water and sanitation;
- Oil-related Products;
- Information and communication technology (ICT);
- Taxes;
- Transportation costs by logistic service providers and the quality of the service delivery;
- International flight costs and reliability of airlines (e.g. delays);
- Security costs and quality of security firms (e.g. references by previous clients);
- Customs and import duties;
- Insurance (e.g. for real estate, products, shipments, etc.).

These cost factors are compared to projected sales volumes and available incentives. The intelligence gained from phase 2 will form the basis of this analysis.

The outcome is an overview of the financial feasibility of an investment project in the different identified locations. The model allows the calculation and comparison of a number of financial ratios for each location such as the net present value (NPV), internal rate of return (IRR), total profit & loss expenses and total net income (figure 7.7). An additional assessment includes the financial impacts of the different incentive packages offered by the different locations that are still in the scope of winning the investment project. A best practice example is to calculate the NPV of the investment project without incentives compared to the financial situation in which the incentives are incorporated.

The investor will have firm-specific data to undertake this analysis which are not easily available to the IPA. The IPA will have location-specific data which may not be easily available to the investor and may be requested to provide these data to the investor.

(d) Phase 4: Site visits

Normally, in this phase site visits are prepared: an assessment of local service providers is made together with an evaluation of the resources for site visits. During this phase, IPA project managers arrange for meetings and introductions to relevant government departments, existing investors, and agencies and services providers. The potential investor will check for important market entry factors. The importance of this phase cannot be emphasized enough as it enables the IPA to directly influence the investor. It is a fundamental part of investment facilitation which will be further discussed in chapter 8.

Figure 7.7. Financial feasibility analysis of various investment locations

Financial Summary & Assumptions

(All Amounts in €000's)

	Metric	Location A	Location B	Location C	Location D	Location E	Location F
		Country					
7	Net Present Value	2 933	2 920	2 920	2 964	2 965	2 895
8	Rank	3	4	5	2	1	6
10	Internal Rate of Return	19.4%	19.4%	19.4%	19.5%	19.5%	19.3%
11	Rank	3	4	5	2	1	6
13	Total P&L Expenses	22 711	22 621	22 618	22 923	22 928	22 445
14	Rank	4	3	2	5	6	1
16	Total Net Income	853	849	849	861	861	843
17	Rank	3	4	5	2	1	6

(All Amounts in €000's)

	Regional	Location A	Location B	Location C	Location D	Location E	Location F
		Country					
8	Markup From	23 564 146	23 469 997	23 467 757	23 783 983	23 788 567	23 288 296
9	Cost of Sales						
10	Raw Materials	18 000 000	18 000 000	18 000 000	18 000 000	18 000 000	18 000 000
11	Chemical Duties/Tariffs	304 000	304 000	304 000	304 000	304 000	190 000
12	Material Transportations	2 400 000	2 400 000	2 400 000	2 700 000	2 700 000	2 300 000
13	Electricity	72 120	72 120	72 120	84 360	84 360	93 600
14	Salaries & Wages	244 710	173 546	171 853	163 066	166 531	189 000
15	Payroll Tax & Employee Benefits	63 624	45 122	44 682	42 397	43 298	49 140
16	Depreciation Expense	1 357 590	1 357 590	1 357 590	1 357 590	1 357 590	1 357 590
17	Total Cost of Sales	22 442 044	22 352 378	22 350 245	22 651 412	22 655 778	22 179 330
19	Gross Margin	1 122 102	1 117 619	1 117 512	1 132 571	1 132 789	1 108 966
20	Taxes	269 305	268 229	268 203	271 817	271 869	266 152
21	Net Income	852 798	849 390	849 309	860 754	860 920	842 815
23	Total Expenses (Incl. Taxes)	22 711 348	22 620 606	22 618 447	22 923 229	22 927 648	22 445 482

Source: Investment Consulting Associates.

(e) *Phase 5: Real estate strategy and final site selection*

Finally, in phase 5 the real estate and land requirements are highlighted and compared for the different site options. Especially in large FDI projects, the facility and land acquisition process is in many cases subject to negotiations. After this phase is completed, the result is a fact-based and well-informed location decision based on the following parameters:

- Strategy plan towards internationalization;
- Country/location and business risk assessment, including challenges and showstoppers;
- Analysis, benchmark and ranking results;

- Financial business case;
- Site visit intelligence and a detailed location assessment for each location analysed;
- Important inputs from subject matter experts (e.g. plant directors, real estate brokers, information, communication and technology, human resources, legal, etc.);
- Real estate plan;
- Final recommendations of the most favourable site.

Table 7.2 provides two cases of the decision of an investor engaged in both production, R&D and innovation on site selection and indicates the main factors in the location decisions of the concerned companies. When production offshoring or re-shoring is followed by R&D offshoring or re-shoring, and there is functional interdependency between production and R&D or innovation, one may speak of “co-location” of these business functions (Idea Consult, 2014).

Table 7.2. Case study: European companies’ investment location decisions in the Asia-Pacific region*

	Case 1	Case 2
Sector.	Construction products, innovative materials.	Non-ferrous metals.
Size: no. of staff.	>50,000	10,000-25,000
The “case”: host country.	Presence of production and R&D activities in China and India.	Presence of production and R&D activities in China, Japan and the Republic of Korea.
Co-location?	Yes. The co-existence of R&D and production in both China and India is functionally related.	Yes. The co-existence of R&D and production is functionally related.
Location factors (ranked from most to least important).	• Local market presence; • Cost structure; • Local incentive schemes; • Connections to local organizations; • Access to university clusters/research communities.	• Presence in important market areas; • Presence near the customers; • Presence in important technology areas; • Business friendly administration and low red-tape level.
Value chain considerations.	Proximity to customers and markets is very important.	Presence of a value chain is very important. Customer requirements/ negotiation power. Importance of being present in leading technology areas (scientific excellence of universities in China, Japan and the Republic of Korea).
Market considerations.	Market presence is main driver.	Market presence is main driver. Local presence is requested by the customer.
Strategy.	Support production (develop solutions for local market). Help local business (propose innovative solutions for local market).	Start of possible new activities.
Technology and innovativeness.	Highly R&D intensive company.	Highly R&D intensive company.
Product and production characteristics.	Highly complex product and production process.	Highly complex product and production process. There are local adjustments to the product.
Main impact on home country.	Increase in global sales and revenues.	Activities in Asia contribute to the overall sales and revenues of the company.
Main impact on host country.	Strengthen local innovation development and capability. Employment effects.	Positive employment effects.

Source: Idea Consult (2014).
Note: For confidentiality reasons, the names of the participating companies are not made public.
* A “case” has been defined as a (co-)location decision/event involving production, research and/or development, or innovation, or a combination thereof (e.g. investment in a new production facility abroad).

2. Benchmarking for the investment promotion agency: a closer look

The process for site selection as described above is also followed by the IPA. IPAs already engage in benchmarking their location when they develop the USP. For IPAs, the strategic assessment normally involved a SWOT analysis of a location (box 7.6) followed by a benchmarking exercise that compares the location in terms of strengths and weaknesses with other competing locations, both at home and in other host countries. This is also called **competitive positioning** (Loewendahl, 2001). Benchmarking is the process of comparing one's business climate and performance metrics to other regional or global competitors to find out:

- Why are they better?
- What are they doing that makes them better?
- What can we learn?
- How can we catch up?
- How can we become the best in a specific category?

Thus, benchmarking is important:

- To *understand the complexity* of investment location decisions by potential investors;
- To provide an *objective and realistic "picture"* of the host location compared to competing alternative locations in the region;
- To assist the potential investor in making a *fact-based investment decision*;
- To present the IPA as a *knowledgeable and professional* organization;
- To continuously *provide insight, monitor* the USPs and *mitigate weaknesses* of the location.

Box 7.6. SWOT analysis for location benchmarking

A SWOT analysis is important to assess a location's strengths, weaknesses, opportunities and threats vis-à-vis other locations. In order to make this assessment, a set of questions needs to be asked. These questions need to be based on a careful evaluation of investor needs and preferences. For instance:

Strengths and **weaknesses:** With regard to strengths, from the perspective of the investor what is attractive of the site/location as a potential investor site in terms of: available labour; proximity to infrastructure (SEZ?), natural resources and/or nearby markets; telecommunications; recreation; area specific investment rules and incentives, etc. With regard to weaknesses the question is: from the perspective of the investor what is lacking in the site/location that the investor needs? The same terms and criteria can be used.

Strengths and weaknesses can be assessed on an absolute basis without reference point except the needs and priorities of the investor. However, a similar assessment made on a relative basis (with reference to SWOTS for other locations) they can be adapted on the basis of the benchmarking exercise which may reveal that perceived strengths may actually not be as strong as originally thought or that weaknesses may not be as bad compared to other locations.

Opportunities and **threats**: here the question is: what are the key trends and developments that are emerging that are positive (opportunities) or negative (threats) to attract investment to a certain location (opportunities). Opportunities and threats may affect a location's current strengths and weaknesses which are therefore not static but will change over time. Both opportunities and threats, like strengths and weaknesses, are very location- specific but typical trends and developments that translate into opportunities may be recent liberalization initiatives in a particular sector, conclusion of a bilateral or regional investment agreements or regional trade agreement, discovery of new deposits of natural resources, construction of a state-of-the-art SEZ, pending privatization initiatives, introduction of new incentives, etc. Obviously, changes in investment policy can provide both opportunities and threats depending on whether the policy changes are liberalizing or restricting FDI. Similarly, threats may consist of environmental degradation undermining the sustainability of an investment, labour unrest and strikes, incidence of a natural disaster (earthquake, cyclone, floods and droughts, etc.); change in government with different ideas about FDI, expiration of favourable trade privileges, changes in multilateral trade agreements, electricity outages due to insufficient utilities infrastructure, etc.

Strengths, weaknesses and, in particular, opportunities and threats need to be identified by the IPA in close consultation with stakeholders, including domestic and foreign investors and key government ministries and agencies and civil society through round tables and interviews. The results need to be independently verified and detailed through further research. The objective of such an exercise is to obtain a realistic assessment of the potential of a given site/location as a potential investment destination for a particular investment in a particular specified sector.

Source: World Bank/MIGA (2000a).

Benchmarking should not result in copying another location's characteristics as conditions are never identical. Understand critical variables and apply them to your unique case and environment. It is rather about identifying gaps, using policy advocacy to address and react to implement necessary measure to close the gaps.

IPAs need to understand the company's business and ideally its expected cash flows and seek to improve the location in order to ensure that these expectations can be met. When undertaking benchmarking on the basis of financial ratios, it is important that all sources and definitions are completely clear and applied on a consistent basis for each location. Otherwise the IPA will be comparing apples with oranges.

Indeed, the basic premise behind benchmarking is that countries can compete for FDI by understanding the approach of an investor in search of a site for investment. Benchmarking also has an aftercare function in that it strengthens relationships with existing investors as it has a focus on retaining current investments and support expansion (i.e. brownfield) FDI. Despite overarching benchmarks, every company has its own formula for weighing myriad location variables that influence the process. In addition, each location has its own set of opportunities to position itself for various niches of investors and IPAs and policy-makers should be aware of this. On the whole, benchmarking could prove to be a useful tool for IPAs and policy-makers too as it reveals complexities and gaps in their investment climate on the one hand and depth and sophistication of the site-selection process of corporate investors on the other hand.

IPAs need to undertake various steps for a comprehensive effective benchmarking exercise:

- Benchmark against investor needs.
- Identify the investment facts and figures of potential investors such as:
  - How many jobs will the project need?
  - What kind of jobs?
  - How much land or office space does the potential investor need?
  - Volume of utility usage;
  - Transportation/Containers.
- Identify list of competing candidate countries and/or regions for specific potential investment projects in your region.
- Identify relevant location factors for the investment projects such as:
  - Labour costs;
  - Taxation;
  - Access to public transport.
- Identify which location factors are critical and which are important to the success of the investment projects such as:
  - Critical: low labour costs;
  - Critical: utility costs;
  - Important: availability of skilled labour;
  - Important: accessibility.

The benchmarking should also be consistent in terms of timing. In other words, location characteristics need to be gathered for the same time period in order to be comparable.

In order to undertake the benchmarking exercise, IPAs need access to information, data and statistics of specific locations. Such information is not always readily available and may be accessible at a substantial cost. Potential sources of information are factual reports undertaken by commercial entities; statistics bureau, Eurostat, United States Census, national and regional bureaus; international organizations: UNCTAD, World Bank, OECD; free zones and industrial parks: survey data on cost items; specialized media and online groups: EIU, FDIexecutive, Creopoint, etc.; proprietary data sources and direct interviews. A comprehensive database is provided by the Financial Times fDi Benchmark Services (**https://www.fdibenchmark.com**) containing comprehensive data series covering the main competitiveness indicators for more than 600 locations around the world.

3. Preparing and presenting the Location Value Proposition

(a) Preparing the LVP

Benchmarking provides the basis for the preparation of powerful LVPs which provide investors with a clear overview of all relevant business factors in the host country. That makes the LVP one of the most important and frequently used marketing tools used by IPAs. While location benchmarking is usually coupled with investor perception surveys in the context of image building, LVPs are a step upward and more suitable for investment promotion purposes, containing more comprehensive information. The LVP should highlight all important business climate factors that relate to the host country or location. Investment locations that are offering unique capabilities and reasonable cost levels generally rank high in benchmark exercises - i.e. are attractive to investors

LVPs do not only show statistics, they help in drawing powerful conclusions that will result in an appealing value proposition. The strength of doing both is that the IPA's value proposition is very convincing to potential investors. Keep the value proposition short and simple and develop one for each of the priority sectors. Use qualified sources only (direct quotes, up to date prices, etc.).

Box 7.7 shows an example of a powerful LVP in the information technology (IT) sector in South Africa.

Box 7.7. Example of a value proposition in the IT-sector in South Africa

- Find the IT staff needed for your operation: 17,000 people are employed in IT services in the Cape Town region. Additionally, with 45,000 students, Cape Town has a large supply of educated people entering the workforce each year.
- Number one location for software and IT services in Sub-Saharan Africa: Cape Town is the leading location for software and IT services FDI in Sub-Saharan Africa, with investors including Amazon.com, Computer Sciences Corporation, Propel Software, End2End, Amcat, Tamar, and Escrow Europe. In addition, there are over 200 IT and software companies in Cape Town.
- Large and vibrant market: Cape Town has a €40 billion economy, which is larger than the economies of Dublin, Budapest, Warsaw, or Prague. Strong economic growth will ensure Cape Town will continue to offer many business opportunities for ICT companies.

More recently, South Africa has embarked on attracting business procss outsourcing and offshoring (BPO&O) and has developed a value proposition for that purpose.

Source: IT Value Proposition for Wesgro, Cape Town, developed by fDi Intelligence, Financial Times Lt.

The example shown in box 7.7 shows that business factors (17,000 IT workforce, 45,000 students, €40 billion economy) increase the credibility of the value proposition. Presenting business factor statistics in combination with an attractive value proposition is a very convincing marketing tool.

(b) Presenting the LVP

In order to effectively promote a location, senior IPA officers must obtain good presentation skills. This includes not just the delivery of the presentation but also the preparations of it.

All too often IPA officials use very generic presentations that can be used with virtually any audience, but this is not necessarily a good tactic. They should *tailor* the presentation to match the interests of the audience and use timely facts and figures to justify promotion statements. Of course, this is more difficult when the audience is diverse compared to a focused group from a particular sector, but nonetheless the IPA should try to target the presentation to the type of audience it expects to address. The IPA should also ensure that the presentation has a clear purpose. What are the key points the IPA wants its audience to come away with? Remember, as stated before, you never get a *second* chance to make a *first* impression.

If it is not certain how much time has been allocated to deliver the presentation, the organizers should be asked beforehand. If the presentation is too long for the time allocated, then it may not be possible for the presenters to deliver all the important messages.

Table 7.3. Typical outline of a location value presentation

Main theme	Topics
1. Title slide.	Begin with your (image building) theme that outlines the value proposition or specific business opportunity for investors.
2. Key description and benefits of the location, including cost advantages.	Highlight the key capabilities and cost advantages or distinctive strengths of your country/location specific to the sector, including quality of life (schools and entertainment, etc.). Include a map of the country and its locations (e.g. provinces, key municipalities, EPZs, etc.) in relation to the wider region of which the country is part and include key transport nodes where relevant.
3. Factual evidence.	Use facts to demonstrate the capabilities and costs factors of your country/location, including graphs/tables comparing your country/location with other locations. Show that your country/location stands out in a specific sector.
4. Present key laws and regulations affecting the possible investment.	Rule of law is very important to investors. Show them the prevailing laws and regulations that are pertinent to the investment, in areas such as ownership (e.g. joint ventures), land, social and labour, exchange, law enforcement and arbitration, import and export, environment, bilateral investment treaties, etc.
5. Support services – including incentive support.	Provide short information about the services the national/local IPA can provide, including available incentives, one-stop shop services, and aftercare.
6. Testimonials/case studies.	Include investor testimonials or case studies of successful investments in the specific sector/location.
7. Top 10 reasons why.	Repeat your message to conclude the sales presentation by summarizing the top 10 reasons why to invest in...

Source: Investment Consulting Associates. *IPA Handbook* (2012).

Most professional presentations these days are made in Microsoft PowerPoint and projected onto a screen. This method is preferred to simply reading a text because it is more interesting to the audience (it offers some visual stimulation) and enables the presenter to show tables and graphics if necessary (see table 7.3 for a typical outline).

A common mistake made in presentations is the inclusion of numerous statistics. Reciting a series of statistics is quite boring for an audience, and most likely they will not remember all the details even if they are listening carefully. Often the font of the statistics in large tables is too small to be clearly visible for a larger audience. Hence, only use selective statistics that have an express purpose, but also summarize what the trends are based on those statistics. Make sure that the presented information is accurate and up-to-date.

The delivery is as important as the preparations for the presentation, because in many instances this will be your first impression to prospective investors. A good presentation and strong delivery will convince investors that the IPA is professional, which increases the chances that they will consider an investment in the location presented by the IPA. Therefore, IPAs should take the time to practice the presentation in advance. The IPA should be clear of the content it wants to show and of the key messages it wants to convey. Presenters should look good and professional, have excellent presentation and speaking skills, and speak clear English or the local language of the investor's home country fluently. Presenters should interact with and engage the audience and stimulate a dialogue instead of a monologue. In other words, presenters should not simply read to the audience, and certainly not in a heavily accented or barely audible voice. The closing statement of the presentation or value proposition is important because that is the last chance to convey key messages. Presenters should summarize the main points and make a call to action for investors, such as meeting with the presenter and IPA colleagues after the presentation or offering to arrange site visits for them.

In summary, key best practices in delivering the sales presentation include the following:

- Rehearse and review the presentation before it is delivered. Ideally, if more than one investment officer from the IPA is presenting, they both should do a dry-run together.
- Agree with the investor on when the meeting will start and finish, and ascertain whether the investor has a tight schedule so as to plan the presentation accordingly. Then stick to the time limit.

- Before going through the presentation, each IPA official present should give a brief introduction to his/her role and to the organization, covering why the meeting was sought and what it seeks to achieve.
- The presentation should be concise and aligned to the critical needs of the investor.
- It is good practice to have a pre-prepared list of frequently asked questions with the answers written down, separate from the main presentation. If the complete answer to a question is not known, one should note it down and tell the investor somebody will get back to them. Then get back to them with the answer as soon as possible and do not let it linger.
- Investors are primarily interested with factors that affect their profits and costs and with the quality and availability of labour for many forms of investment. The presentation should make sure it covers these key issues.
- At the end of the presentation, IPA staff should ask key questions related to the international strategy of the company and whether they are likely to consider their country for investment and in what timeframe. If the investor has already pre-selected or shortlisted the country, one can ask the investor whether the IPA could assist in a specific site visit.
- Confirm at the end of the meeting the next steps the IPA will take; after the meeting, follow up with information and actions agreed.

IPAs, like the companies they seek to attract, increasingly use professional agencies to undertake benchmarking and preparation of LPVs. One source to find all FDI-related professional advice is **www.fdiprofessionals.com**, a database developed by WAVTEQ. This databased contains information on a wide selection of FDI professional agencies in various areas, including site selection, which help IPAs to get a particular location on the investor's map and promote the location to the right people in key organizations and companies.

D. INVESTMENT PROMOTION TOOLS: WEBSITES AND SOCIAL MEDIA

1. Developing and enhancing a website

One of the most important investment promotion tools for an IPA is its website. There are at least three major advantages of using the website for investment promotion: (a) it can be accessed by anyone with an Internet connection; (b) virtually all of your various promotional tools can be contained on the website; and (c) it is very cost effective compared to reproducing hard copies of all the promotional materials.

However, creating an effective website is not an easy task. It requires good planning for the layout, development of content, design, and some technical expertise to make all the required linkages between sections of the website. Websites of some of the highly regarded IPAs around the world, such as those of Australia, Spain; Hong Kong, China, and Singapore provide good examples of attractive websites (table 7.4).

Table 7.4. Top best practice IPA websites (2012)

Top 10 globally	Top East Asia	Top West Asia
Austria: ABA – Invest in Austria (**www.aba.gv.at**)	**Hong Kong, China**: InvestHK (**www.investhk.gov.hk**)	**Armenia**: Armenian Development Agency (**www.ada.am**)
Czech Republic: CzechInvest (**www.czechinvest.org**)	**Philippines**: Philippine Board of Investments (**www.boi.gov.ph**)	**Georgia**: Georgia National Investment Agency (Invest in Georgia) (**www.investingeorgia.org**)
Australia: Austrade (**www.austrade.gov.au**)	**Singapore**: Singapore Economic Development Board (**www.sedb.com**)	**Turkey:** Investment Support and Promotion Agency (**www.invest.gov.tr**)
Germany: Germany Trade and Invest (**www.invest-in-germany.de**)	**Taiwan Province of China**: Department of Investment Services (**http://investtaiwan.nat.gov.tw/cht/main.jsp**)	
Denmark: Invest in Denmark (**www.investindk.com**)	**Thailand**: Thailand Board of Investment (**www.boi.go.th**)	

Table 7.4. *(continued)*

Top 10 globally	Top East Asia	Top West Asia
Spain: Invest in Spain (**www.investinspain.org**) **Turkey**: Investment Promotion Support and Promotion Agency of Turkey (**www.invest.gov.tr**) **Nicaragua**: PRONicaragua (**www.pronicaragua.org**) **Taiwan Province of China**: Department of Investment Services (**http://investtaiwan.nat.gov.tw/cht/main.jsp**) **Hungary**: Hungarian Investment and Trade Development Agency (**www.itdh.hu**)		
Top Developed Asia	**Top South Asia**	
Japan: Japan External Trade Organization (JETRO) (**www.investjapan.org**) **Republic of Korea**: Invest Korea (**www.investkorea.org**)	**Bangladesh:** Board of Investment **(www.boi.gov.bd)**	

Source: World Bank Investment Climate, Global Investment Promotion Best Practices (2012). Available from **https://www.wbginvestmentclimate.org/advisory-services/investment-generation/investment-policy-and-promotion/gipb/best-practice-web-sites.cfm.**

IPAs should include a variety of promotional materials and relevant data on their website either as links to other webpages or as downloads. Before launching the website live on the Internet, it should be tested offline a few times to make sure everything functions properly. Following the launch, IPAs should keep in mind that maintaining a website is an ongoing process. This includes updating the information provided by the website, posting new materials and information on the website, and testing of the website regularly. If maintenance fails, the website will get outdated very quickly and eventually become a negative piece of marketing.

Posting the website on the Internet is not enough to promote the site. It is important that the website is registered with the leading search engines to make sure the site is included in their retrievals when a user conducts an Internet search. This is referred to as Search Engine Optimization (SEO). The IPA should also consider issuing a press release when the website is launched or significantly modified. Another technique for promoting the website is to make agreements with other institutions for reciprocal links to each institution’s website. In this regard, it is important to identify relevant public and private sector institutions to investment, such as chambers of commerce, government ministries and agencies, the host country’s embassies and consulates, among others. It is common for national IPA’s to have links with subnational (provincial/municipal) IPAs and vice versa.

These days, the website is the IPA’s access to the outside world. The Internet has become the first and primary tool for investors to do investment location and site selection research. Therefore, a website is not only important for information provision and image building, but it is also a primary tool for generating investment leads and increasing FDI projects in the host country. Ideally, the website should contain some form of Customer Relationship Management (CRM) system to capture those investors who are interested in learning more about the host country or potential investment location.

2. Best practices and components of a successful website

In fact, typically 60-80% of FDI leads come through the website or from referrals from existing investors (VCC, 2009). A high-quality website can make a significant difference to the level of investment inquiries a host country receives. Research on “best in class” websites used by IPA’s around the world shows that, while the structure of the website varies depending on the specific services of an IPA and characteristics of the host country, a broadly common design template is in practice.

According to the World Bank’s Global Investment Promotion Best Practice Report (World Bank, 2012), the best Asian IPA website is the one from the Department of Investment Services, Taiwan Province of China (**http://investtaiwan.nat.gov.tw/eng/main.jsp**) (figure 7.8).

Figure 7.8. Regional best practice: website of Invest in Taiwan

Source: Available from **http://investtaiwan.nat.gov.tw/eng/main.jsp**.

Globally, the highest scoring website, Invest in Austria (Austrian Business Agency’s site: www.aba.gv.at), offers a simple architecture, good sector segmentation, and innovative mapping technologies (figure 7.9). Key information can be found quickly in seven languages and downloaded if required.

What are the components of a successful IPA website? In order to create a well-structured website, you first need to set goals:

- **User goals:** It is important to understand what the users want to achieve when they visit the site and that they understand how the site is organized.
- **IPA goals:** It is also important to consider what the IPA wants to achieve: are there pages or sections of the site that need to be promoted? For instance, if the aim is to make investors read investor project proposals, these should be highlighted on the opening page or be featured prominently.

The IPA should be clear on what it wants to achieve with its website. Without this understanding, there will be confusion and the IPA will waste time and resources. The IPA should be aware of the reason why it is creating a website in the first place and work towards its successful implementation. Some typical objectives of a websites are:

Figure 7.9. Global best practice: website of Austrian Business Agency

Source: Available from **www.aba.gv.at**.

- **Educating and informing**: providing learning resources;
- **Marketing**: promotion of the country and the IPA services offered to investors;
- **Support function**: dealing with investor requests via email, phone and feedback forms;
- **Business support**: providing support information for an investor application or business process;
- **Community**: building a forum or community that investors use to share ideas, experiences, issues, etc.

For the purpose of promoting investment, the following ten components of a world class website can be identified (see e.g. Loewendahl, 2001; World Bank Group, 2012):

- **Authenticity of place branding and messaging**:
  - Communicating a true and unique positioning of the region (USP);
  - Utilizing recognizable national elements;
  - Capturing users' attention to inspire them to use the site.
- **Clarity and ease of navigation:**
  - Use a simple top bar and/or simple side menus;
  - A prospect-specific section placed prominently;
  - Straightforward navigation;
  - Providing the top 10 most requested pages;
  - Keeping all valuable content three clicks or less from the homepage.
- **User friendly:**
  - East of reading, using medium sized font (Verdana or Arial);
  - Appropriate use of graphics;
  - Easy downloads of PDF documents.
- **Depth and quality of content:**
  - Using a content management system that enables publishing of pages, downloadable documents, and data;

- Weekly updates on news items and events;
- Offering video content;
- Direct – one click – access to investment guides;
- Accurate information with references;
- Provide only relevant information (box 7.8)

Box 7.8. Relevant information for an IPA website

It is tempting to add too much clutter to the website supposing that all possible information may be relevant for investors. However, investors are more impressed with websites that gives them information that matters (see table 7.5 below) i.e. that is relevant for them. Relevant information consists of:

- Costs of doing business, including operating costs;
- Site and location advantages;
- Business environment: taxes and regulations etc.;
- Available incentives;
- Sector specific information (manufacturing, services);
- Information that can be used for benchmarking and site selection;
- Factsheets;
- Investment and partnership opportunities;

Ideally, the information is properly categorized and uses multiple metrics and currencies for international investors. The information must be provided in English and language of other major investor home countries. The key to relevant website content is:

- Understand your users. This is the key to developing meaningful and comprehensive content.
- Segment your audience and prioritize your users (investors, site selection advisors, media, researchers, etc.).
- Focus on helping each user type achieve its goals when visiting your website.
- Start with the content you have and evaluate it for relevance, quality, and comprehensiveness.
- Use reliable sources of content.
- Then, fill in the gaps.

Table 7.5. Information investors and site selectors really need

What they really need	What they do not really need
• Contact information; • Incentive programmes; • Tax rates and cost info; • Recent announcements; • Testimonials; • Industry-targeted info; • Map of your territory; • Largest employers; • Area colleges and universities.	• General labour statistics; • Secondary source wage information; • General rankings; • Distance to other major cities; • General climate and weather conditions.

Source: ICA, World Bank Group (2012).

- **User segmentation:** mainly for foreign and domestic investors
- **Use of search marketing approaches:**
  - Search engines connect those who are already looking to you
  - Clicks can be free (large list in main column), but ranking is harder to get
  - Clicks can also be paid (ads at right), and be at the top of the list on the same day.

- Ensure that searching your location or IPA name results in being on top of the list;
- Utilizing paid search (pay-per-click or PPC) to drive additional traffic.[129]

- **Effective use of email marketing and news sections**:
  - Monthly email newsletter to investors, prospects;
  - Tracking performance of those newsletters;
  - Posting newsletters and news items to the IPA website weekly or monthly;
  - Stay up-to-date. If not, "news" is counterproductive.
- **Frequent and effective performance tracking:**
  - Receiving a performance report (of the region and of the IPA) once per month;
  - Not using "hits" (i.e. no. of searches by search engine for the website) – bad indicator;
  - Tracking unique investor visits (resulting in follow-up), web references (by search engine) and number of downloads;
  - Integrated tracking of advertising, web and PR effectiveness;
  - Use Google Analytics for track and trace.
- **Use of maps and Geographic Information System (GIS) technology is essential for site evaluation and selection purposes** (box 7.9):
  - Integrated with IPA website;
  - Using maps with various layers (transportation, education, etc.);
  - Using integrated real estate searches/GIS mapping software;
  - Generating dynamic demographic and business reports;
- **Use of new and social media:** website should have effective linkages with social media:
  - Providing links between IPA website and its LinkedIn and Facebook profiles;
  - Keeping an active Twitter account;
  - Having a blog and updating it four times per month;
  - Incorporating "share" features on your site.

Box 7.9. Availability of GIS in IPA websites

An important aspect of attracting investors is the ability of investors to evaluate and compare various sites/locations for their investment. For that purpose, IPA websites need to provide comprehensive and relevant information of possible investment sites. Very helpful in this respect is the provision of geographical information systems (GIS) that are integrated into IPA websites. Such systems allow investors to get a close-up view of the area/location/site they wish to evaluate. Sophisticated GIS use maps with various layers (transportation, education, etc.), allow integrated real estate searches and generate dynamic demographic and business reports. The GIS should include available properties and companies (for M&A or partnerships) and infrastructure, existing FDI companies and community assets such as international schools, business parks, ports, and airports. The GIS should be updateable without programming. The benefits of GIS for investors are:

- Comprehensive data investors demand, delivered online;
- FDI property database that highlights trophy properties in a location;
- Database of successful companies doing business in a location;
- The location's assets on an accessible, updateable map;
- Locational data comparing the location's competitiveness to that of other locations nearby.

The next generation GIS are 3D and satellite based which allow investors virtual familiarization tours of a certain location.

Source: ICA.

[129] Pay-per-click (PPC), also called cost per click (CPC), is an internet advertising model used to direct traffic to websites, in which an advertiser pays a publisher (typically a website owner or a network of websites) when the ad is clicked.

With the goals and objectives in mind the IPA can use the following basic website template:[130]

- **About us:** information about the IPA: brief history, mission and vision statements, objectives, management team, structure and organizational diagram; annual reports.
- **Services:** information on investment facilitation services, including site visits and aftercare services with contact details of relevant officials; business registration procedures and forms; one stop shop services for other permits and licenses.
- **Information on general business and investment climate: doing business in** [summary with below sub-navigation]:
  - National economy overview [summary of key aspects of the domestic economy and FDI in the host country with fact sheet for download];
  - Regional economy overview [summary of key aspects of the host country's main economic regions and FDI in the regions within the country with fact sheet for download];
  - Overview of relevant legislation, including investment laws and regulations, land and labour laws and regulations, banking laws and customs procedures, etc.;
  - Overview of available land, transport and utilities facilities (industrial estates and special economic zones) including:
  - Overview of costs of doing business: utilities, labour, land rents, working capital, transportation;
  - Quality of life;
  - Testimonials from existing investors;
  - Useful links and contacts (Chambers, ministries, embassies, departments, agencies, banks, media etc.).
- **Investment opportunities** in the host country [summary investor project proposals with below sub-navigation]:
  - Sector A [summary of value proposition and key benefits of the sector with fact sheet for download];
  - Sector B [summary of value proposition and key benefits of the sector with fact sheet for download];
  - Sector C [summary of value proposition and key benefits of the sector with fact sheet for download];
  - Etc.
- **Press** [below sub-navigation]:
  - News [what's new in the host country/location – investment announcements];
  - Publications [links to relevant publications].
- **Inquiry form** [e-mail inquiry form and telephone / fax contact points].
- **Contact us.**

In many instances, the investor's first impression of the IPA and location will come from the IPA's website. A website that is poorly designed, contains many spelling and grammar mistakes, or has buttons and links that do not function properly will convey a negative image about your agency and location. Be sure that the website is well-designed, professional looking, and contains updated information. Well-designed and interactive websites encourage feedback by users. They also enable an IPA to evaluate the number of "hits" on the IPA's site. In addition, **Google Analytics** is a useful and free web analytics tool offered by Google that tracks and reports website traffic though it is most useful for small websites rather than for large and complex ones. It provides statistics and basic analytical tools for search engine optimization and marketing purposes. Web analytics help determine whether the website is an effective promotional tool. Nonetheless, this information needs to be compiled on a regular basis to determine whether the content of the website is still attractive to users and if the number of visits is increasing or decreasing.

3. Use of social media

Social media, or "Web 2.0" are increasingly used by investors and site selectors. ICA research found that LinkedIn was the most used source for information, followed by Facebook. Twitter and RSS feeds are also increasingly used. Social media allow IPAs to have frequent and effective communications and linkages with all

[130] Developed by Loco Software Ltd. as quoted in VCC (2009). Loco Software is based in Ireland and develops online applications for the development of websites for investment promotion agencies worldwide. They can be accessed at http://fdiapp.com/indexFdiWebsites.html.

stakeholders. IPAs therefore need to have a strong presence on social media with direct links to and from their website. LinkedIn, in particular, is growing rapidly and is the world's most comprehensive and active professional networking online media tool. LinkedIn not only provides IPAs with the necessary connections, it also provides discussion, support and interest groups which makes the search for investors easy.

The most important global social media for IPAs are the following:

- **LinkedIn** (**www.linkedin.com**): most active professional networking website
- **Shareslide** (**www.shareslide.net**), owned by LinkedIn:
  - Access to many slide and PDF presentations: great way to market a IPA's message visually;
  - Re-purpose presentations;
  - Cross-link to other social media sites;
  - Largest community for sharing slides globally.
- **Soundcloud**: (**www.soundcloud.com**):
  - Distributes the IPA message by voice through podcasts, smartphone and iTunes.
- **Youtube**: (**www.youtube.com**):
  - Distributes the IPA messages online by video (visual and sound);
  - Allows for academic presentations on development issues; showing lifestyle, investor testimonies, property and site tours, etc.
- **Twitter**: (**www.twitter.com**)
  - Social networking and microblogging;
  - The SMS of the Internet;
  - Use Twitter Counter (http://twittercounter.com) for track and trace showing statistics of more than 10 million Twitter users and for monitoring and evaluating allowing the IPA to see when, how often and who interacts with them.
- **Web-blogs and webinars**: used less frequently as the contents are more difficult to verify. Blogs are also more time consuming and need continuous updating to stay active.

According to social media magazine *Social Media Examiner*, 85% of marketers surveyed reported the top advantage of social media is to generate brand exposure, while 52% maintained that they used it to generate qualified leads. fDiMagazine found that LinkedIn and Twitter were the two most popular platforms among IPAs.[131] Facebook is used less frequently as the client base of IPAs is mostly executives who are usually not very active on Facebook. With executives from each of the Fortune 500 companies registered as LinkedIn members, and 65% of the world's top 100 companies having a Twitter account according to E-consultancy, combining a Twitter account with a LinkedIn profile has become a popular strategy for IPAs.[132]

The above-mentioned social media are very Western oriented and some of them are banned in particular countries. Therefore, IPAs often need to seek recourse to national level social media. In China in particular, there are many social media developed by national giants such as Baidu, Alibaba, Tencent and Sina (collectively known as "BATS"). These media specialize in e-commerce, fintech and mobile communications. Weibo (**www.weibo.com**) resembles Twitter, while Wealink (**www.wealink.com**) resembles LinkedIn and Renren (**www.renren.com**) resembles Facebook.

The use of social media is not without risk, in particular as they are not particular to any business. An IPA cannot control the audience and the information it derives from social media websites. There is a risk that an IPA portrays a wrong image. It is therefore important that the IPA makes conscious choices as to which social media it will work with and what the purpose is. fDiMagazine found that the more successful IPAs placed content at the heart of their interactions. The ability to provide informational value on these platforms enabled the IPA to attract and retain the most relevant clients. Having a clear purpose, a willingness to experiment and invest time will therefore be the only way IPAs can successfully adapt to the rapidly evolving requirements of the emerging world of Web 2.0.[133]

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[131] fDi Intelligence article by Barbara Njai: "Have IPAs finally grown to love social media?" 6 April 2012. Available from **http://www.fdiintelligence.com/Locations/Europe/Spain/Have-IPAs-finally-grown-to-love-social-media?ct=true**.

[132] Ibid.

[133] Ibid.

In conclusion, various web 2.0 tools can support all IPA activities. However, the implementation and maintenance of all tools require discipline, continuous updating, hard work, dedicated resources, dedicated research and an innovative mindset.

E. AN OVERVIEW OF OTHER COMMON INVESTMENT PROMOTION TOOLS

1. Introduction

As indicated above, awareness creation, image building initiatives and basic investment promotion typically include the preparation and distribution of marketing or promotional materials such as brochures, newsletters and videos. Other forms of awareness and image building activities, apart from websites, include public relations and advertising; and seminars and presentations. The effectiveness of these activities can be gauged through consultations with business groups both at home and abroad (using overseas offices or embassy representatives).

Methods to capture investors' opinions on such image building and investment promotion methods include "open houses", hospitality events, focus groups, surveys and interviews. The feedback received from target audiences on the effectiveness of these methods needs to be tracked and incorporated into the subsequent design and/or use of investment promotion materials.

When developing new promotional materials, the IPA should double-check their veracity and consistency with the IPI's other promotional messages. Assessing the quality and utility of the IPAs promotional materials is desirable. The effective distribution of marketing materials is as important as the quality of the material itself. Too often, staff time and financial resources are devoted to the production of materials, and too little time is spent on planning how to get that material into the hands of targeted investors. Box 7.10 lists other considerations when preparing promotion materials.

Box 7.10. Effective investment promotion materials

It is tempting for IPAs to run away with the preparation of promotion materials. More often than not, budget is a major constraint but even when there are sufficient funds, it is important to consider strategically the impact of various promotion materials and the needs of the investor. Generally speaking, below are some of the observed considerations to take into account when preparing investment promotion materials.

- In general, IPAs have found that excessively elaborate materials are less effective than updated and accurate information.
- It is more important for investors to have good information than good graphics.
- Given the very attractive cost element, most IPAs are now focusing attention much more on multimedia tools and websites.
- One element that is often overlooked in promotion materials, and one that is critical for investors, is operating cost comparisons. Accurate information on cost comparisons must be included in all promotional materials.

Source: Investment Consulting Associates.

The main tools for investment promotion are quite similar to those used for image building. However, with regard to investment promotion, more detailed information and more pro-active interaction with investors is required. Many of these tools are used for investor targeting (see section F below) but can also be a tool to generate wider investor interest. Unlike in the case of image building, it is not simply the image of the country or location the IPA seeks to improve; this time it is really about convincing investors that your location is the most superior in meeting investors' needs. Some of the outstanding tools were discussed before for the purpose of image building, and are again presented here in more detail for the purpose of investment promotion.

2. Brochures

From the outset of investment promotion, the IPA needs to have at least a basic package of essential information that can be given out to prospective investors. Over time the IPA can develop additional promotional

tools, but an informative, high quality brochure is indispensable. Along with the IPA's website, often the first bit of information that prospective investors will see about a particular location is the basic brochure, and thus it is important to make an initial good impression to encourage the investor to learn more about what the location has to offer.

Most brochures are produced in the local language and in English, but more advanced IPAs often have their brochures in multiple languages, depending on the major source countries of FDI. Always be sure to have a good editor (especially a native speaker of the language) review the layout of the brochure, correct any typographical errors and spelling mistakes, and address formatting problems.

In general, the brochure should contain at least an overview of all the key types of information an investor would need to know, such as the services provided by the IPA, statistics on investment, the main selling points of the location, cost benchmark data, macroeconomic data, and contact information. The information needs to be accurate, up-to-date, relevant to investors, and "packaged" nicely. A good example of an excellent brochure is provided by InvestHK in Hong Kong, China: **http://www.investhk.gov.hk/wp-content/uploads/2017/01/2017.01-corporate-brochure-en-v3.pdf**. Another good example of a more comprehensive overview booklet (rather than brochure) is Invest in Canada: **http://international.gc.ca/investors-investisseurs/assets/pdfs/download/1-Flagship_Report.pdf**. Figure 7.10 shows a typical investment promotion brochure which is not too bad but perhaps somewhat heavy on text, could do with better propositions and could contain better and clearer data and infographics and contact details.

Developing a high-quality IPA marketing brochure is a challenging task. The following key principles provide some guidance:

- Always remain objective;
- Always use independent sources and provide definitions;
- Always provide relevant and accurate information;
- Always communicate a clear message using correct language;
- Always use appealing styles, visuals and content;
- Always avoid spelling mistakes and typographical errors.

These six principles are straightforward and common sense, but in practice they are often neglected. In addition, in terms of lay-out and presentation of content there are a few guidelines that can be used to comply with international quality standards:

- Marketing material should follow the KISS(S) principle: Keep It Short, Simple but Specific, i.e.
  - Keep it concise and stick to the point;
  - Avoid difficult terminology and abbreviations (e.g. SCM: supply chain management);
  - Only include investor relevant information and be precise (no information about climate but provide factual data on the business environment of the location);
- Corresponding pictures and informative tables are more powerful than long sentences

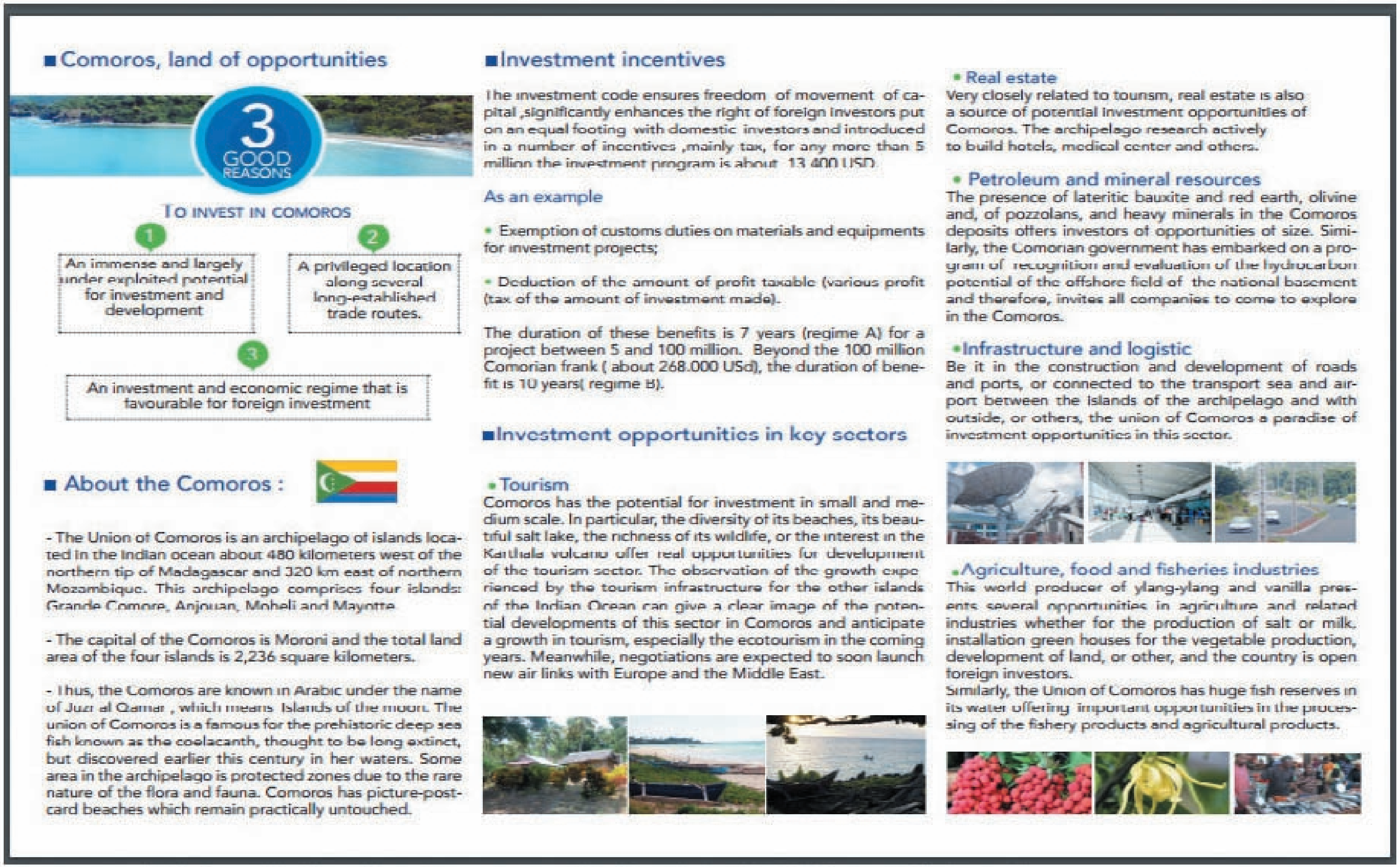
Table 7.6 summarizes specific guidelines relating to style, visuals and content of a marketing brochure for investment promotion purposes.

3. Sector and opportunity profiles

In addition to the basic brochure about the IPA and location, other materials can be developed that are more tailored to the particular endowments and opportunities available to investors in a particular location. **Sector profiles** provide specific information about sectors in which the location is deemed competitive. Focus on developing materials only for those sectors that have been assessed to offer the greatest potential for investment opportunities. It is not worth preparing sector profiles for sectors that lack critical endowments or competitive factors, because investors will find other locations that offer such advantages.

A frequent oversight by many IPAs in preparing sector profiles is that they do not explicitly explain what distinguishes the investment location from others in that same sector. Investors always have choices of where to locate their investment, so the sector profiles must contain convincing information to help the investor decide that the promoted location meets his or her requirements best.

Figure 7.10. Example of an investment promotion brochure: Comoros National Investment Promotion Agency (NIPA)


■ Comoros, land of opportunities

3 GOOD REASONS

TO INVEST IN COMOROS

1 An immense and largely under exploited potential for investment and development

2 A privileged location along several long-established trade routes.

3 An investment and economic regime that is favourable for foreign investment

■ About the Comoros :

- The Union of Comoros is an archipelago of islands located in the Indian ocean about 480 kilometers west of the northern tip of Madagascar and 320 km east of northern Mozambique. This archipelago comprises four islands: Grande Comore, Anjouan, Moheli and Mayotte.

- The capital of the Comoros is Moroni and the total land area of the four islands is 2,236 square kilometers.

- Thus, the Comoros are known in Arabic under the name of Juzr al Qamar , which means Islands of the moon. The union of Comoros is a famous for the prehistoric deep sea fish known as the coelacanth, thought to be long extinct, but discovered earlier this century in her waters. Some area in the archipelago is protected zones due to the rare nature of the flora and fauna. Comoros has picture-post-card beaches which remain practically untouched.

■ Investment incentives

The investment code ensures freedom of movement of capital ,significantly enhances the right of foreign investors put on an equal footing with domestic investors and introduced in a number of incentives ,mainly tax, for any more than 5 million the investment program is about 13 400 USD.

As an example

- Exemption of customs duties on materials and equipments for investment projects;

- Deduction of the amount of profit taxable (various profit (tax of the amount of investment made).

The duration of these benefits is 7 years (regime A) for a project between 5 and 100 million. Beyond the 100 million Comorian frank (about 268.000 USd), the duration of benefit is 10 years(regime B).

■ Investment opportunities in key sectors

- Tourism

Comoros has the potential for investment in small and medium scale. In particular, the diversity of its beaches, its beautiful salt lake, the richness of its wildlife, or the interest in the Karthala volcano offer real opportunities for development of the tourism sector. The observation of the growth experienced by the tourism infrastructure for the other islands of the Indian Ocean can give a clear image of the potential developments of this sector in Comoros and anticipate a growth in tourism, especially the ecotourism in the coming years. Meanwhile, negotiations are expected to soon launch new air links with Europe and the Middle East.

- Real estate

Very closely related to tourism, real estate is also a source of potential investment opportunities of Comoros. The archipelago research actively to build hotels, medical center and others.

- Petroleum and mineral resources

The presence of lateritic bauxite and red earth, olivine and, of pozzolans, and heavy minerals in the Comoros deposits offers investors of opportunities of size. Similarly, the Comorian government has embarked on a program of recognition and evaluation of the hydrocarbon potential of the offshore field of the national basement and therefore, invites all companies to come to explore in the Comoros.

- Infrastructure and logistic

Be it in the construction and development of roads and ports, or connected to the transport sea and airport between the islands of the archipelago and with outside, or others, the union of Comoros a paradise of investment opportunities in this sector.

- Agriculture, food and fisheries industries

This world producer of ylang-ylang and vanilla presents several opportunities in agriculture and related industries whether for the production of salt or milk, installation green houses for the vegetable production, development of land, or other, and the country is open foreign investors.

Similarly, the Union of Comoros has huge fish reserves in its water offering important opportunities in the processing of the fishery products and agricultural products.

Source: Available from **http://www.invest-comoros.com/attachments/article/389/Brochure%20An.pdf**.

Table 7.6. Summarizing guidelines on style, visuals and content of a marketing brochure for investment promotion purposes

Style	Visuals	Content
Use a different text style to present a quote or testimonial and always mention your source.	Use pictures to professionalize your brochure, but make sure that the resolution is sufficient to avoid unclear pictures.	Must be factual and to the point.
Use same style (colours, lay out) throughout the brochure.	Use pictures that correspond with the text.	Use bullet points to summarize your key strengths.
The style of graphs and tables should all be consistent.	Use pictures that reinforce the text.	Use tables with comparative cost data (e.g. wages, business taxes, business start-up costs, rent rates).
Avoid unreadable text due to wrong use of colours.	Use of logos (especially from large TNCs) is appealing for investors.	All graphs and tables should be presented with a title and a source.

Source: Investment Consulting Associate. *IPA Handbook* (2012).

Consider, for example, what sets a particular location apart from other locations competing for investment in fisheries or forestry. Box 7.11 provides a sample sector profile for fisheries in Fiji but this profile lacks any meaningful data for investors or any reason why they should invest in the sector. Good sector profiles would not merely describe the features (e.g., species, amount of potential resources, production levels, etc.) of a sector in a location, but also highlight any advantageous cost factors or other competitive advantages such as access to specialized processing facilities or transportation corridors that show that the location offers the entire competitive package for investors in those industries.

Box 7.11. Sector profile for investment in Fiji: Fisheries

Fishing is cherished for its recreational and social aspects in Fiji. In relative terms, fisheries are the third largest natural resource sector, behind sugar and “other crops”. Another important sector in Fiji is tourism, which has an important relationship to the fisheries sector.

The fisheries sector boasts diverse resources of marine life species. These species range from finfish products such as fish species like yellow fin tuna, big eye tuna, albacore tuna, marlin, swordfish, mahi-mahi, and deep-water fish like snapper and reef fish species like sea- bream, trevally, groupers, coral trout and rock cods to aquaculture products which include prawn, seaweed, giant clam and tilapia farming. The overall performance of the sector over past years is attributed to increased catch and prices of tuna for the Japanese sashimi market. The performance of the sector is closely linked to the growth of offshore fisheries. Fish from Fiji export frozen, fresh chilled and loins of tuna, reef fish, bêche-de-mer, etc. to overseas markets, to name a few.

SUPPLY:

The Government has several strategies to increase the national fish supply. This involves facilitating private sector growth, promotion of aquaculture, encouraging the harvesting of tuna resources by small-scale fishers, and supporting the marketing of fishery products landed in remote parts of the country.

EXPORTING:

Tuna export to the European Union (EU) market:

Compliance to EU fish export standards requires vessels, crew, processing plants and storage facilities certified by the Competent Authority.

Tuna export to other markets:

For major Fiji markets such the United States, Japan, Australia, Canada, European Union markets and New Zealand, the exporter is required to adopt and implement the following food safety systems:

HACCP (Hazard Analysis Critical Control Point System) Plan;

Standard Sanitation Operating Procedures Plan (SSOP); and

Good Manufacturing Practices Plan (GMPP).

POTENTIAL FISHERIES INVESTMENT OPPORTUNITIES:

Aquaculture:

Prawns, shrimp, seaweed, sea cucumber, tilapia, milkfish, pearl oyster, sea grapes, Asian carp, ornament fish, giant clams and trochus.

Offshore fishery:

Tuna as the major foreign exchange earner for Fiji's fishing industry is boosted by the development of domestic tuna long line cannery and processing companies and to the vast lucrative sashimi and sushi markets in Japan and the United States. Major export products include:

Deep water snapper;

Tuna species – big-eyed, yellow fin, albacore, skipjack;

Other species – swordfish, blue marlin, striped marlin, mahi-mahi, wahoo; and

Sunfish.

Inshore fishery:

The inshore resources that are exported include aquarium commodities such as ornamental fish, live ornamental invertebrates, live coral and live rock.

RESOURCE BASE:

Fiji has in the 200 nautical miles Economic Zone archipelagic baseline in an area totalling -1,290,000 square kilometres. The large stock of marine resources such as tuna species of Yellow fin, Skipjack, Albacore, and Big eye in the EEZ presents a lot of opportunities for investment.

There are 411 registered "Qoliqoli" or customary fishing right areas throughout Fiji, which support the Inshore Fisheries. There are also non-tuna species namely marlin, sailfish, mahi-mahi, barracuda and opah. The inshore waters of Fiji are the bases of the reef fish. The coastal waters, coastal mangroves and surrounding reefs have large stocks of fish, crabs, clams, shellfish, prawns, lobsters, etc. In addition, a variety of seaweed is also available in the Fiji waters.

APPLICATION FOR EXPORT PERMIT:

An export Permit from the Fisheries Department is required for the export of fish and other marine products. Application for a Convention on International Trade in Endangered Species of Wild Fauna & Flora Permit. Convention on International Trade in Endangered Species of Wild Fauna & Flora (CITES) listed species are administered under the Endangered and Protected Species Act (2002) and the Endangered and Protected Species Regulations (2003).

INCENTIVES OFFERED:

Specialized machineries directly used for fisheries and forestry purposes. The importation under concession is subject to the condition that a letter of approval is issued by Department of Fisheries & Department of Forests in relation to goods under concession.

Fiscal Duty – free; and

VAT – 15%.

FOREIGN INVESTMENT REGULATIONS FOR THE FISHERIES SECTOR IN FIJI:

Under the 2009 Foreign Investment Regulations (FIR) and Foreign Investment (Amendment) Regulation 2013 the following activities in the Fisheries Sector is restricted as follows:

FISHING (commercial):

At least 30% equity held by Fiji citizen(s) and the foreign investor must have at least $500,000 in owner's contribution or paid-up capital for companies in the form of cash from the operational date, to be fully brought into Fiji within the implementation period.

In addition, all other fisheries activities do not have a minimum investment requirement.

Source: Investment Fiji. Available from **http://www.investmentfiji.org.fj/pages.cfm/for-investors/sector-industry-profiles/fisheries.html**.

Most IPAs also produce **opportunity profiles** or specific project proposals to steer investors towards tangible investment opportunities. In some cases, opportunity profiles will present a single project opportunity providing several details, while in other cases a set of brief profiles might be included in one document. For both types of opportunity profiles, the following information should be contained for each project:

- Name and contact information of project initiator;
- Description of the project;
- Financing estimates;
- Estimated return on investment and expected payback period;
- Form of cooperation (e.g. lease, joint venture, etc.);
- Any relevant incentives offered by the government.

Opportunity profiles are an excellent way for domestic firms to "advertise" joint venture opportunities. In a sense, these profiles can pave the way for matchmaking with foreign firms.

4. Investment project proposals

Investment project proposals (IPPs) are specific defined projects in particular sectors or industries that foreign investors can invest in. They can pave the way for direct FDI or matchmaking opportunities between domestic and foreign firms. This means that IPPs are an excellent opportunity for domestic firms in the host country to "advertise" joint venture opportunities for foreign investors.

A professional IPP will strengthen the investment proposition of your IPA and positively influence perceptions among investors. It will also encourage investment in those sectors and industries that are most urgently needed in your country.

There are four main sections in IPPs:

- **Market context**: briefly elaborate on project promoters, current market conditions, growth forecasts and sector overview for that specific investment opportunity in the location;
- **The investment opportunity**: this is a concise business case with information on market orientation, project capacity parameters, business processes, competitors, etc.;
- **Description of technical requirements**: (a) a brief overview of technical requirements (e.g. project engineering, production process requirements); (b) overview of current business costs: labour costs, utility costs, etc.;
- **Expected benefits for the investor**: elaborate on potential incentives (e.g. tax breaks) and other specific benefits for the investor.

The point of departure is to develop **one IPP** in each of your **priority sectors**.

- Explore and evaluate investment opportunities;
- Use the provided investment proposal template to collect the data;
- Contact the business community, universities and colleges to gather appropriate data;
- Develop basic graphs and maps;
- Draft informative notices based on data collected and include them in the appropriate sections of the proposal;
- Illustrate project proposal sections with related pictures, maps and graphs;
- Establish a basic list of the main international or local companies potentially interested in direct investments (see targeting presentation).

Each IPP requires a lot of details which are generally not easy to find. There are solutions to collect as much information as possible:

- Make use of a template to start the data collection process;
- Work together with the business community (e.g. sector experts, sector associations, financial experts, banks, engineering companies, property developers, etc.);

- Work together with academics (e.g. experts in the field of technical engineering, civil engineering, architecture, finance and accounting);
- For large scale IPPs, an external consulting company may be hired.

The IPA may include external sources to compare and verify data, which improves the overall quality of the IPPs. The IPA may also contact subject matter experts to improve its knowledge about specific sectors or industries. As a result, developing IPPs directly improves the IPA's inquiry handling capabilities; however, sharing this knowledge with team members is critical. The IPA will enjoy a growing network of professionals which makes the difference between successfully attracting FDI or not.

A good example of a list of investment project proposals is the list provided by the Board of Investment of Sri Lanka at **http://www.investsrilanka.com/images/publications/pdf/Structured_Projects_Proposals.pdf.**

5. Newsletters, press releases and fact sheets

Besides brochures, an IPA should periodically distribute newsletters. Newsletters are periodic announcements of news items sent to a large group of recipients. A cost-effective way of releasing newsletters to a very large audience is through the Internet, while hard copies of newsletters can be used for specific industry events or investor meetings.

Newsletters are commonly used by IPAs to keep investors up-to-date on what is happening in their location (figure 7.6). They are very effective for maintaining regular contact with investors and help people to remember the location. For relatively new or small IPAs, newsletters can be prepared and distributed bi-monthly or quarterly. A monthly newsletter is normally too burdensome for small IPAs because of the intensive effort required for writing, formatting, and disseminating high quality newsletters every month. It may also be costly depending on the quality of paper, prints and lay-outs.

Rather than merely having all sorts of miscellaneous updates and news, it is useful to at least occasionally develop a particular theme (e.g. policy reforms) or highlight a selected sector (e.g. food processing) in a particular issue of the newsletter. Investors often find these types of newsletters very informative because they contain a lot of condensed information on a particular sector or a current issue of concern to investors.

Newsletters are a key marketing instrument for communicating with existing and potential investors, stakeholders and the wider investment community. It also allows an IPA to segmentize and selectively communicate with a particular group of recipients depending on the theme or subject. It can be distributed to an individually selected audience and is more targeted than advertising and public relations campaigns. The contents of the newsletter will vary in each issue. Example contents are:

- Trends in investment, e.g. an annual or quarterly data stream;
- Sector related items and (sector) events;
- New infrastructure plans/developments;
- Major companies announcing new investments or important investments; currently under implementation;
- Major changes in the policy environment;
- Case studies and testimonials;
- Interviews with subject matter experts;
- Activities of the agency, e.g. trade shows, new staff, etc.;
- New sector studies or benchmark studies on the host country;
- Headline news on the host country;
- Findings from international studies on the host country or main regions within the host country;
- Interviews with investors and other stakeholders;
- What the international press says about the host country.

The newsletter should be produced by the IPA and disseminated to its mailing list by e-mail and posted on its website. Figure 7.11 shows an example of a high-quality newsletter issued by Invest in Spain.

Figure 7.11. Best practice in investment promotion newsletter: Invest in Spain

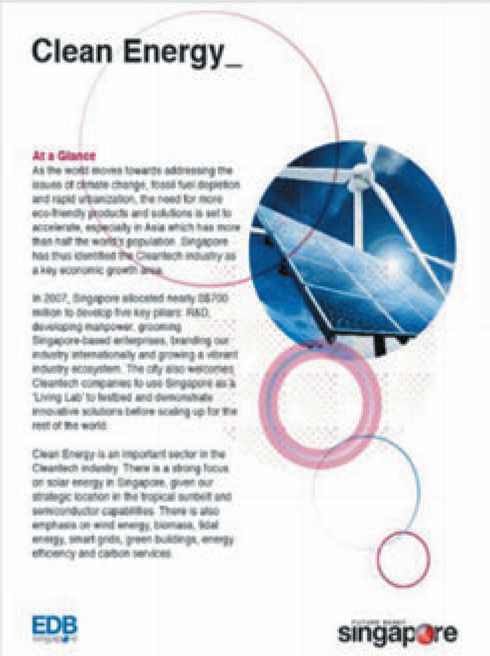
Strong points are:

- A headline article;
- Regional investment announcements;
- Sector highlights;
- Business Indicators
- Events;
- Success story and Interview.

Source: Available from http://www.investinspain.org/invest/en/press-room/periodicals/newsletter/newsletter-detail/CWB2016661564_EN_US.html.

Another effective tool for disseminating important information is fact sheets. The IPA can produce these occasionally to provide concise information to investors. Fact sheets play an important role in image building but also for investment promotion. As discussed before, fact sheets should only be 1-3 pages in length and updated easily. Some possible topics for fact sheets include utilities rates, labour costs, key government agencies and important contacts for investors, government policies, investment incentives, customs procedures, and many more (box 7.12).

Box 7.12. Fact sheets from the Economic Development Board in Singapore



EDB Singapore provides on its website six different factsheets regarding six specific industries that the country has identified as key economic growth area: aerospace, clean energy, electronics, precision engineering and infrastructure. Short (never exceeding five pages long), insightful and based on facts, those sheets aimed at future investors effectively highlight Singapore's strengths and ambition.

In order to convince and gain the trust of investors, EDB Singapore firstly states how prominent Clean Energy is for the country: "Clean Energy is an important sector in the Cleantech industry. There is a strong focus on solar energy in Singapore, given our strategic location in the tropical sunbelt and semiconductor capabilities. There is also emphasis on wind energy, biomass, tidal energy, smart grids, green buildings, energy efficiency, and carbon services."

Second, Singapore's IPA highlights the already existing infrastructure supporting the industry: "The Energy Innovation Programme Office (EIPO) is Singapore's key inter-agency workgroup responsible for planning and executing strategies to develop the energy sector in Singapore. Since its inception in 2007, EIPO has launched several key initiatives, including the establishment of public sector R&D centres, competitive funding and talent development programmes.

The third point of the argumentation lies in the competitive advantage of Singapore. "The city is already a major semiconductor hub and has all-round capabilities from the precision engineering and chemicals industries which can all be applied to the solar and wider clean energy industry." Singapore's other advantage, according to the fact sheet, is that the country is "located on the sunbelt which gets about 50% more radiation than the temperate regions such as Germany and Japan which are major hubs for solar technology today."

Last but not least, in its quest to convince investors, the EDB mentions the case of worldwide known companies such a Panasonic, which have already çset up an energy solutions R&D centre in Singapore, which is a key part of Panasonic's global strategy to grow revenues from eco-friendly products and solutions."

Therefore, the EDB's fact sheets which are based around four key points - importance of the industry for the country, the existing infrastructures, the nation's competitive advantages and the examples of companies which already trusted the Singaporean's investment environment – appear to be good examples to follow by others IPAs in order improve their attractiveness.

Source: Available from **https://www.edb.gov.sg/content/dam/edb/en/resources/factsheetsnew/Clean-Energy.pdf**.

6. Other promotion tools

There are other investment promotion tools that are more advanced and expensive such as advertising campaigns and seminars and investment forums. While such tools are also used for image building they are probably more suitable as investor targeting techniques (see below).

Public relations (PR) and advertising: An important part of most investment promotion campaigns is public relations, including the establishment of relations and contacts with key people in the media; providing information, success stories, and testimonials; hosting visiting journalists; and, monitoring media coverage. An IPA needs to systematically monitor its media coverage, especially the publications read by targeted investors, and assess the results. Another form of investment promotion is advertising. This is an extremely expensive promotional tool. If it is used, it should be closely monitored to determine whether it is an effective use of resources. The best way to determine if an advertising campaign has been accurately targeted and is having the desired effect on the intended audiences is to ask members of that audience. Reply cards, surveys, and direct consultations are all effective means to do this.

Loewendahl (2001), while citing evidence that PR campaigns associated with image building are much weaker in producing investment leads than company-focused sector targeting, observes that there is a strong argument for PR campaigns when: (a) the reality in a country is better than the perceptions held by the international investment community; (b) a country has not been a major host for FDI in the past; (c) domestic policies are reformed providing an opportunity for the agency to change its image; (d) there is a change in strategic direction by the IPA, for example, by focusing on new sectors or activities.

Seminars, investment forums and conferences, and presentations: Other investment promotion activities include speeches, seminars, and presentations to business audiences; çopen housesé or hospitality sessions by the IPA; participation in trade or investment shows or forums or other business events; and, briefings to key investor organizations and intermediaries. An IPA needs to monitor these activities to determine which is resulting in the largest number of subsequent inquiries. This is useful information to obtain because many of these activities can be expensive, particularly if they involve staff travel overseas.

The most successful investment seminars or conferences are sector-based and include presentations by satisfied investors (Loewendahl, 2001). As a result, private sector çchampionsé or çambassadorsé are frequently used for promotional purposes. For example, they are often asked to make formal presentations, to participate in investment missions, or to talk favourably about the location in one-on-one conversations with potential investors. Most will be pleased to support a location’s efforts to attract more investment. However, not all businesspersons are effective. Some may be critical and negative. Some may be poor public speakers and better engaged in informal conversation or smaller meetings. Some will be less informed than necessary about desired messages or specific policies. Finally, some will expect more support than the IPA can provide. The performance of business champions needs to be tracked and assessed to ensure the most effective use of such partners. Remember, first impressions count! The presentations made to prospective investors should be truthful, to the point, interesting with an appropriate number of informative graphics (not graphics for graphics sake!) and limited text, and given by a person who is fluent in the language of the audience and has a certain flair and sense of humor to engage the audience. Presentations in the context of location marketing are further discussed below.

In conclusion, IPAs have a wide variety of promotional tools and materials at their disposal to help attract investors, ranging from sector profiles and project opportunities to cost benchmarks and investor testimonials. It is imperative that the IPA produces high quality promotional materials before embarking on the use of proactive investment promotion techniques in order to provide the kinds of information that investors need to assess the host location and to help convince them that that location is ideal for them.

While there are some common types of investment promotional materials produced by almost all IPAs, the choice of specific types and the format (whether printed, electronic, video, etc.) of the materials and tools is a function of several factors, such as the available budget for the IPA, the availability of or access to in-house skills for preparing and in some cases producing materials, and the type of investors the IPA is trying to reach. The IPA may need to experiment to find out which types of materials and formats work the best. Some common tools are further discussed below.

All investment promotion tools described above can be printed and/or produced electronically, but they should also be incorporated into the IPA’s web site.

F. INVESTOR TARGETING AND LEAD GENERATION

1. What is investor targeting and lead generation?

As previous chapters have demonstrated, corporate site selectors and investors are faced with information asymmetries and are influenced by perceptions (right or wrong) of certain sites. By means of direct marketing information can be provided to potential investors that in turn may positively affect (correct) the investor’s perception. Information can be provided to companies on commercially viable business opportunities in a location, and encourage an investor to consider investing.

It is an impossible task to contact all potential investors for a certain region and inform them about possible investment opportunities. Therefore, marketing resources have to be focused on companies in selected sectors which hold the highest potential for investment in a given country/location. **Investor targeting** is a technique to attract inward investment in greater quantity and quality, making the most effective use of limited resources (VCC, 2009). Investor targeting involves targeting specific companies in carefully identified sectors and is thus related to

prioritizing certain industries and companies. A 2000 survey by PricewaterhouseCoopers of the most successful IPAs showed that investor targeting, including targeting existing investors (aftercare), is the most successful method of lead generation (VCC, 2009). Harding and Javorcik (2010) found that targeted sectors received twice as much FDI as non-targeted sectors in developing countries.

Most of the world's leading IPAs now target carefully identified investors in specific sectors. This requires a pro-active approach to investment consisting of actively trying to identify investment prospects before inquiries are generated. The prime goal is to generate good quality business leads of investors, who otherwise would not have considered the location for investment. Investor targeting needs to be accompanied by solid relationship-building and effective facilitation to secure a greater quantity and quality of inward investment projects. By pro-actively targeting specific companies, investment promotion contributes to an economic development strategy by stimulating the highest quality companies to invest in priority industries in particular locations.

Investor targeting involves the presentation of well-researched niche "business opportunities" in a given location to specific senior managers in the targeted companies. The major advantages of investor targeting are:

- Focuses effort on the best prospects;
- Can greatly increase investor and broker (investment advisors) awareness;
- Investors respond best to material relevant to them;
- Can help develop local industry clusters;
- Is cost effective – takes time more than money;
- Can be outsourced to specialist providers where resources allow.

There are five key principles which define investor targeting:

- Target industries and sectors first and then move to active identification of specific companies and investment projects;
- Carefully plan and manage investor-search programmes;
- Investigate and analyse specific corporate priorities;
- Engage in confidential promotion to specific corporate executives;
- Maintain single agency leadership.

When companies are first contacted by an IPA, it is unlikely that these companies will have immediate FDI projects ready that the host location can compete for. The key to successful investor targeting is staying in touch with the targeted companies on a sustained basis, so that, in case of an investment project, the IPA and location represented are well positioned to be considered for the investment. This is called **lead generation**. Obviously, it is important that the targeted companies are in line with the host country's/location's competitive advantages and are in line with realistic opportunities that the host country/location can offer.

2. Principles and key steps of effective investor targeting and lead generation

Investor targeting and lead generation are the most sophisticated and challenging activities an IPA must engage in. The prioritization of actions related to investor targeting by an IPA depends on the specific circumstances of the IPA (VCC, 2009). For example:

- If a location has a large diaspora (population living overseas), implementing a "diaspora" strategy (stimulating this population to re-invest) first may make sense.
- If a location has a competitive advantage in export-oriented services, manufacturing, or in sectors such as pharmaceuticals, then implementing a broker strategy would be high on the list, as companies in these sectors are often advised by brokers.
- If a location already has a reasonable volume of investment inquiries, then a first step may be the profiling of companies based on those inquiries (VCC, 2009).

As a tool to attract FDI in greater quantity and quality, investor targeting is key to pro-active investment promotion. The majority of the world's leading IPAs target specific sectors, specific types of company and specific corporations. Private sector approaches to investor targeting are more and more common practice among IPAs. Effective investor targeting involves segmenting the market and developing networks with decision-makers in key targeted companies in selected sectors and with brokers. A general goal is to generate a good quality of business

leads in securing future FDI projects. Results come from approaching and contacting selected companies on a sustained basis, often after several years. Box 7.13 lists ten golden rules for effective investor targeting.

Box 7.13. Ten golden rules for effective investor targeting

- Rule One: Do your research CAREFULLY.
- Rule Two: Use the investor's eyes and ears.
- Rule Three: Concentrate on listening.
- Rule Four: First impressions count.
- Rule Five: Be reliable and truthful.
- Rule Six: Understand investor needs.
- Rule Seven: Only promise what you can deliver.
- Rule Eight: Always exceed client expectations.
- Rule Nine: Maintain client confidentiality.
- Rule Ten: Focus on the REAL project.

Source: ESCAP.

Experience demonstrates that the most successful approaches to investor targeting involve the establishment of links between IPAs with existing investors and business and the development of personal networks with target companies and intermediary organizations, including industry associations and investment multipliers like real estate companies and location consultants. Sales representation has also proven to be effective, as long as it is performance driven. On the contrary, directory listings and direct mail have proved to be the least effective methods of investor targeting.

Lead generation and conversion (to actual investment) are the key objectives of investment promotion and targeting. Leads are companies that have a confirmed interest to invest in the medium term in a location. Qualified leads are companies that plan to invest in the location in target sectors, and would like to meet IPA representatives to organize site visits. Contestable projects are current projects that investors are considering to implement in the promoted location. It is critical for the IPA to reduce the list of target companies as quickly as possible to leads, qualified leads and contestable projects. It typically takes 18-24 months from the first contact with a new company to the time when the company has a project an IPA can compete for. Investor targeting is a long-term approach that can increase the volume of FDI into a location by at least 20% over a period of time, as evidence suggests. Figure 7.12 shows that, in order to secure two to five realized projects, it will typically be necessary to identify 3,000 carefully targeted companies, out of which, following screening, prioritization and profiling, 600 are shortlisted (known as the **"20% rule"**) (Loewendahl, 2005; VCC, 2009).

3. How to identify target industries?

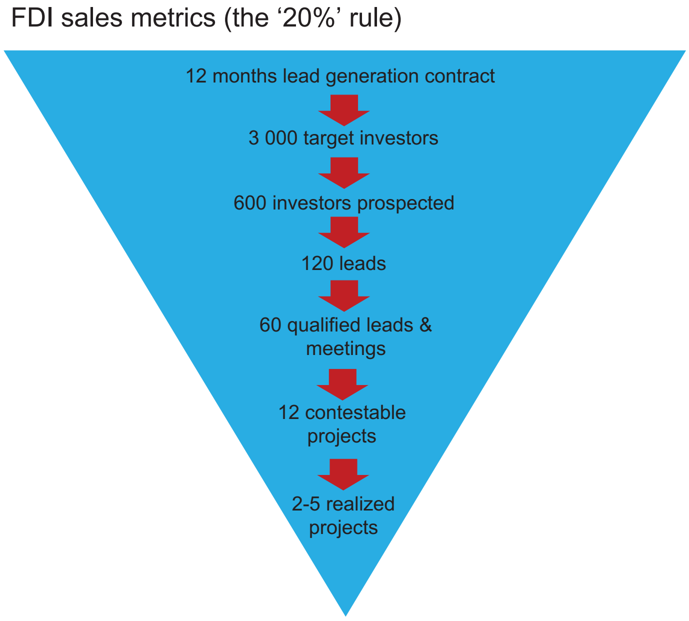
Investor targeting starts with industry/sector targeting before proceeding to individual company or company activity targeting.

Industries or sectors should be targeted according to the following criteria:

- Which industries offer the largest market opportunities in terms of volume of (sustainable) FDI projects;
- Where the industry can fulfil the objectives of investment promotion in the location;
- Where the location can fulfil the location requirements of the sector;
- Where the location can fulfil these requirements better than competing locations.

In this exercise, sectors that offer specific advantages or activities (such as engaging in R&D) may be targeted to fulfil the FDI objective such as headquarter establishment, technology transfer, R&D, etc.

Figure 7.12. From investment targeting to investment realization



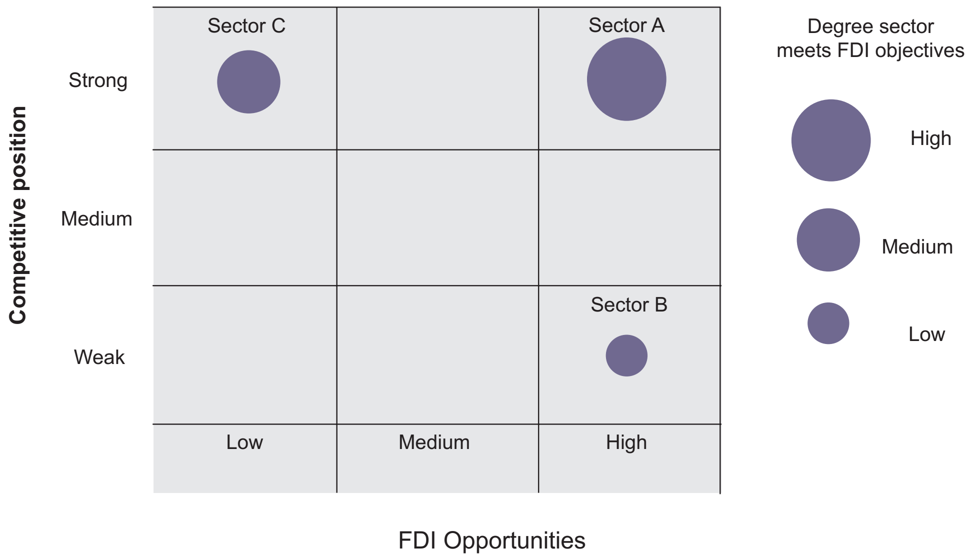
Source: Loewendahl (2005).

VCC (2009) provides the following criteria for identification of target sectors based on a SWOT analysis of the location and comprehensive data research:

- Identifying the top 5-10 sectors in the location, ranked by size of the sector (e.g. by employment);
- Identifying the top 5-10 sectors that have already attracted investment, or that contain the largest and most successful firms;
- Identifying the top 5-10 fastest growing sectors in the location;
- Identifying the top 5-10 sectors that existing investors see as having the best opportunities.

Based on this identification, the challenge is to align sectors with the strength of the location, identify those that have the best prospects for FDI and make the greatest potential contribution to the (local) economy and rank and prioritize the sectors along these criteria. A competitive sector targeting framework using three dimensions consisting of competitive position of the location; FDI growth opportunity and degree to which the sector meets the FDI objective is presented in figure 7.13. The challenge is to attract FDI in the sector in the right top corner.

Figure 7.13. Identifying priority sectors for FDI



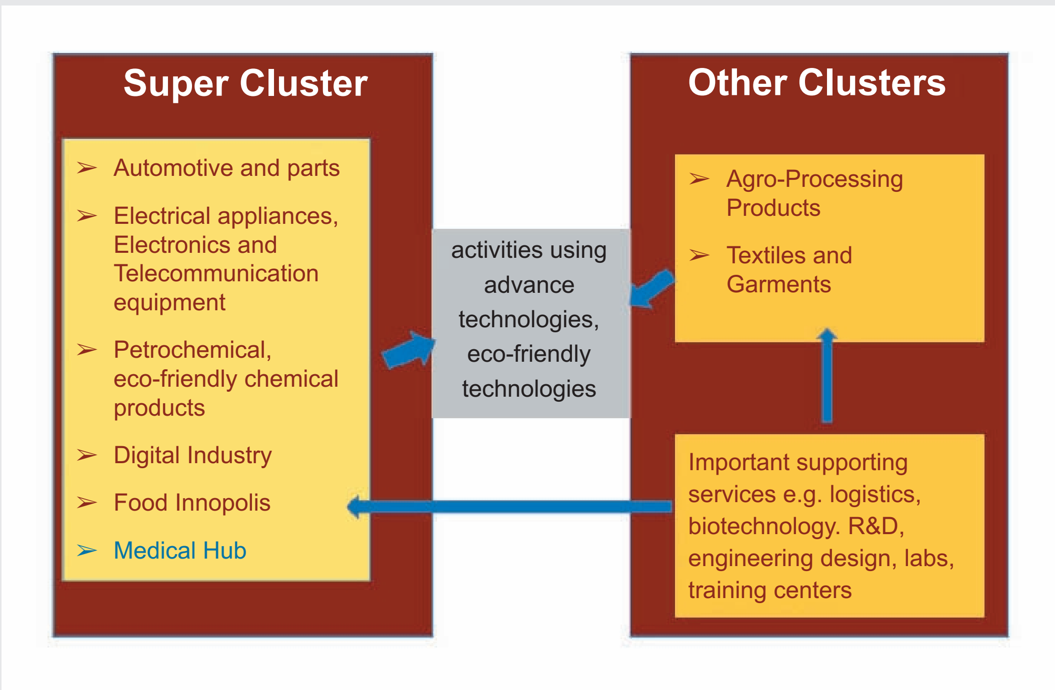
Source: Loewendahl (2001).

Targeted industries (and firm activities e.g. R&D or headquarter establishment) should first and for all meet the economic development objectives of the location. For instance, in the case of Thailand, targeted industries are based on the promotion of industrial clusters (box 7.14). The desired benefits of FDI will also determine the type of FDI projects targeted (e.g. an automotive manufacturing investment will have a qualitatively different economic impact than an automotive R&D investment). While industry targeting is essential to focus on the best FDI prospects, a cluster-based approach is increasingly needed to attract knowledge-based investment. The investment 'proposition' marketed to investors in knowledge-based sectors should be based on the availability of or access to technology and innovation capacity relevant for investors in those sectors. Table 7.7 presents a general industry/sector targeting methodology.

Box 7.14. Targeting sectors in Thailand based on the cluster approach

As part of Thailand's Board of Investment's (BOI) 7-year investment promotion policy (2015-2021), the focus is on the promotion and development of individual industrial clusters. The objective of the cluster policy is to develop potential and manufacturing based areas for target industries to support high technology activities and industries for the future that have linkages between cluster components to enhance industrial competitive advantages. For this purpose, BOI strives towards concentration of specific clusters in strategic locations, strengthening of linkages among cluster components and actors to strengthen the value chain and increase industrial competitive advantage, and enhancing the contribution of clusters to the local economy e.g. local employment, use of local raw materials, and business linkages with local SMEs. For that purpose, a distinction is made between so-called "super" clusters and other clusters for development and attraction of FDI as illustrated in figure 7.14

Figure 7.14. Targeted cluster sectors for FDI in Thailand



Source: Board of Investment, Thailand.

Table 7.7. Sector targeting methodology for FDI attraction

Steps	Particulars/criteria
1. Preparation of an initial list	• Industry structure; • Growth trends; • Inward investment; • Industrial linkages; • Import activity.
2. Pre-screening using evaluative criteria	• Skill intensity ratios; • Technical sophistication; • Transportation access requirements; • Production scale requirements.
3. Analysis of industry-specific trends	• Production/technology trends; • End user markets trends; • Customers & suppliers; • Barriers to entry; • Other competitive forces.
4. Locational fit analysis	• Location of key markets & suppliers; • Labour & skills requirements; • Facility requirements; • Transport requirements.
5. Identifying targets	

Source: Investment Consulting Associates.

Various online tools are available to help IPAs identify sectors for FDI attraction. One such tool is Investment Map developed by the International Trade Centre (box 7.15).

Box 7.15. ITC's Investment Map

Investment Map is a web-based tool that helps IPAs assess which sectors in their countries have successfully attracted FDI and it assists them in the process of prioritizing sectors for investment promotion. It also helps IPAs identify the competing countries for foreign investment and the most active investing countries in specific sectors. Moreover, information on domestic affiliates of international companies enables enterprises to find local links to global supply chains.

Investment Map is not only an FDI tracking tool that offers top-line aggregate figures, but also supplies FDI sector and country breakdowns. Furthermore, it combines information on investment flows and stocks, trade and tariff data, and activities of foreign affiliates under the UN ISIC rev 3 nomenclature. Investment Map provides direct links to other databases, such as the World Investment Directory, Market Access Map and Trade Map, for a complete market assessment.

Investment Map includes:

- Total FDI flows and stocks for around 200 countries and territories;
- FDI flows and stocks, broken down by industry and/or country for more than 115 countries;
- Export and import data and indicators of trade performance for around 227 countries and territories;
- Tariff data applied by 187 countries and faced by 200 exporting countries and territories;
- Information on the location, sales, employment and parent company for over 150,000 foreign affiliates located in developing countries and economies in transition;

A limited version of Investment Map is accessible without registration for the sector and country breakdown of FDI flows and stocks.

Investment Map can be accessed through **http://www.intracen.org/itc/market-info-tools/foreign-direct-investment** or directly at **http://www.investmentmap.org.**

Source: International Trade Centre.

4. Targeting companies

Targeting investors goes beyond sector targeting and requires comprehensive research and analysis. VCC (2009) explains that the challenge is to find companies that:

- **Fit into the existing business environment**. This can mean finding market-seeking FDI, which means leveraging the size of the market in a particular sector to attract new competitors into the field. It can also mean identifying local clusters or agglomerations of companies and then identifying a missing complementarity, which can be filled by an outside investor.
- **Fit into a global value or supply chain**. If the agency is looking to attract efficiency-seeking FDI, then analysing global value chains and determining the geographical and economic advantages of firms locating within a given region can also help to determine whom to target.

However, IPAs can use additional criteria to target specific investments and companies, for instance:

- What form of investment: greenfield, M&A, joint ventures?
- Nationality of investors: any source country of FDI preferred? FDI from developed countries only? Or from other developing countries or RTA partners?
- Clusters/supply chain: companies that are related to or provide supply chain related products/services to companies already present in the host country;
- Size of investors: large companies? SMEs? Related to cluster criteria;
- Sustainability: this should be a requirement: only companies that implement recognized standards of responsible business conduct and have a proved track record in this regard.

Investor targeting, while more cost effective than promotional marketing (PR and advertising), requires more dedicated resources and greater sector-specific and commercial understanding. It takes more time than money. As it is very time-intensive to identify, contact and build relations with key potential investors, the key success factor of investor targeting is a selective approach to maximize use of limited resources. The key to success is what the private sector calls “managing the sales pipeline.” This means that, while one should always ensure having a strong enough sales pipeline (i.e. a number of good quality investment leads) that will help achieve the level of inward investment sought, at the same time the sales pipeline should not be bigger than the IPA can manage. If it is bigger, it will be counter-productive to securing projects.

Generally, there are two main methods an IPA can use to identify target investors:

- Carefully conducted research to build a **database** of potential investors;
- Developing **networks** with relevant organizations to identify investment leads.

A combination of both methods is necessary for maximizing the inward FDI potential. The first method is more scientific-based but ensures that the highest quality, most relevant companies are being contacted. The second method uses business networks to generate investment leads. These networks can both confirm research results (either positive or negative) or give direction to research (by providing hints for good investment leads that need further analysis).

In order to build a **database** of potential investors to prospect for investment, *existing databases* of investor contacts could provide a good basis. Ideally, the IPA already has some form of CRM system that is used to capture records and update contacts with companies as well as to record information on the quality of companies. The primary method to develop the database of companies to target is to identify high potential investors in each of the designated key target sectors. A filter is needed to draw-up an initial list of target companies. The filter can be applied to screen the universe of companies and identify potential companies to target. Secondly, the database should target companies in major FDI home and trading countries. An alternative method is to observe competitor host countries to identify the main home countries of investors in those countries. If companies from a particular FDI home country are already investing in another competing host country, there is a strong likelihood that other companies from the same FDI home country will also want to invest there, as they will be following their customers, competitors and suppliers overseas. In that case, the IPA needs to consider whether they are in a position to provide a superior environment to investors from that home country in that particular sector or perhaps should target another sector, or identify niches in the sector. The database can be developed through linking up with other lead generators (e.g. chambers of commerce, ministries, etc.).

The database should contain a comprehensive company profile for each shortlisted investor. Such a profile should include information on the investor's product and market, its growth potential, market share, existing investment locations, export share, technologies used, production processes, financial performance, business alliances, etc. There are various online resources available to build a database, which are not necessarily free. None of them stands out but they are all complementary. Box 7.16 lists a few prominent ones.

Box 7.16. Online resources and company databases

In order to build an investor database IPA can resort to online databases. Some are provided by international organizations such as ITC's Investment Map discussed in box 7.15. Others are often country-specific. Examples of online resources include the following:

- **Dun & Bradstreet Business Report: http://www.dnb.com** contains information on the operations, ownership, and business background of United States companies.
- **fDi Markets**: www.fdimarkets.com, a service from the Financial Times, is the most comprehensive online database of crossborder greenfield investments available, covering all countries and sectors worldwide and also tracks and profiles companies investing overseas.
- **Strategis Web Site: http://www.ic.gc.ca/eic/site/icgc.nsf/eng/home** sponsored by Industry Canada, presents data in both French and English, and has a wealth of sectoral and other information.
- **Europages: http://www.europages.com** provides data on European market trends, sectoral indicators, and company information (500,000) for 30 countries.
- **STAT-USA: http://www.stat-usa.gov** (from the United States Department of Commerce).
- **EDGAR**: (electronic data gathering analysis and retrieval) system **http://www.sec.gov/edgarhp.htm** was established by the United States Securities and Exchange Commission (SEC).
- **EMIS**: **https://www.emis.com**. A Euromoney institutional investor company that lists over 1.4 million companies from trusted sources in over 250 industries in over 120 emerging markets.
- **Hoovers: http://www.hoovers.com** offers company profiles and information on company officers for free. Paying members can find additional news and background information.
- **Companies Online: http://companies.lycos.com** is a searchable directory featuring detailed free information on 900,000 public and private US companies, all with sites on the Web.
- **Kompass**: **www.kompass.com**: systematic classification of companies in the 66 countries of the Kompass network according to the products and services they furnish. Its 58,000 entries constitute a unique directory that is constantly being updated, translated into 26 languages, offering very large development perspectives.
- **Vault**: **www.vault.com**: provides profiles on thousands of companies through profile pages, rankings, survey data, and employer reviews. Primarily designed for job applicants.

Source: ESCAP.

An effective CRM database should have the following entries:

- Registration (of company containing key company and contact information);
- Step-by-step tracking of company relations (number of meetings held, location, individual names, key outcomes);
- Tracking of site visits;
- Tracking correspondence (faxes, letters, emails with date and key content);
- Key contacts in the company;
- Permits issued (for existing investors);
- Tracking services rendered (for both potential and existing investors);
- Tracking milestones in the investment project cycle;
- Systematic lead classification and assessment: categories of hot, cold, and active; automatic time-out for inactive leads;
- Summary of assignments and key activities undertaken by the IPA;

The main **networks** that can be used for lead generation include:

- **Existing foreign investors**. Existing investors are not only a source of expansion and for upgrading investment projects, but, through their networks of suppliers, customers, competitors and advisors can also often provide considerable insights on investment decisions made by other companies in a particular sector.
- **Local companies**, especially those with international activities, will be a good source of intelligence as to which foreign companies may potentially consider investing in a country/location.
- **Cross-border partnerships** with governments and organizations elsewhere. Trade and enterprise development agencies and chambers of commerce in home countries of potential investors have access to intelligence on companies that are considering expanding overseas.

It is necessary to screen and prioritize companies before contacting them. Efforts should focus on those companies that have the greatest potential for investment, while contact decision makers in each company need to be identified. When an IPA first approaches a potential investor, the project officer needs to have the right mindset. If investment promotion officers believe that it suffices to ask a company if it has an FDI project and then move on to the next company, they will not only be unsuccessful, but they will also very quickly erode their morale and commitment. Approaching companies should therefore not be seen as a methodical exercise; it is not about one-off approaches to a fixed number of companies each day, but rather a market intelligence gathering and relationship building campaign.

Results from investor targeting are only achieved after a concerted period of pro-active lead generation over a number of years. **Year 1** of a campaign mainly achieves intelligence gathering and awareness creation. **Year 2** starts to see results coming in from the lead generation conducted in year 1, as well as new leads being generated in year 2. In **year 3**, strong results should be expected. Three years should be the minimum to engage in investor targeting and achieve results.

After careful screening and contacting, the IPA may be in a position to be invited to make a visit to the company and present its product and promote its location. Important aspects of a successful location promotion presentation were discussed before (table 7.3). Boxes 7.17 and 7.18 lists important points to consider in making a holistic effective company presentation proposed by the World Bank and Forbes respectively.

Box 7.17. Making an effective company presentation (from MIGA Investment Promotion Toolkit)

When the responsible IPA officer ("account executive") is preparing the presentation, the following rules should be taken into account:

- Be on time.
- Anticipate the needs and expectations of the audience.
- Familiarize yourself with company representatives and understand their role in the site selection process. Learn as much as you can about the company by using Internet based resources and the information sources you used when you first identified the company as a target.

The presentation should incorporate the following:

1. Begin by outlining the structure and content of your 20-minute presentation but prior to doing so ask the company to clarify their specific project interests. If necessary, adjust your presentation to make sure that these interests are adequately addressed.
2. When making the presentation, use the following techniques:
   - Develop an attention-grabbing introduction (short to the point and relevant anecdote).
   - Prepare and utilize visual aids. Use colourful PowerPoint slides.
   - Make sure that the visual presentation provides useful and relevant information and outline the benefits to the company. Do not clutter the slides with too much text or information. Make sure there are no spelling mistakes.
   - Be persuasive and support any questions/objections/queries with facts, logical arguments, and independent testimonials (that are real, not fake!).

- Maintain good eye contact with the audience. Do not make the common mistake of simply reading from the slides.
- Keep to the time allotted for the presentation.

3. Outline the type of visit programme that you can prepare for the company.
4. Know the regularly scheduled flights so you can emphasize how easy it is to visit your location.
5. Use the meeting to learn as much as possible about the company's intentions. For example, ask questions about: other countries on the company's short list; key factors in their selection of a location; details about the size and type of their investment; time frame for their decision; and any other information they require to make a decision. Even better is when you have done prior research and ask more detailed questions which give the company the impression that you have done your homework and are genuinely interested in the company's investment. Try to identify the company's existing perceptions and concerns and try and find out as much as possible about the actual decision-making process: who makes the decision, who influences the decision, and who might want to block the decision.
6. Press for visit dates that could be conveniently scheduled.
7. Ask for a brief tour of the company's plant – this will help you to get a better feel for their production process and (skill) requirements.
8. At the end of the meeting, precisely summarize the key decisions and actions that must be undertaken and confirm the timeframe within which response will be given.
9. Within 24 hours send a courtesy email to the participants confirming the actions agreed upon.
10. Keep on following up within regular intervals (e.g. one month, and more frequently when the company has shown interest).

Source: World Bank (2000c). MIGA Investment Promotion Toolkit Module 6: Targeting and Generating Investment Opportunities (Box 11).

Box 7.18. Forbes: 9 tips for more powerful business presentations

1. Establish your credibility right up front:
   - Avoid lengthy introduction and career highlights;
   - Present a relevant short shorty or share an experience that shapes the presentation or conclusion.
2. State your goal early in the presentation.
3. Use supporting materials liberally:
   - Use statistics, references, quotes from well-respected persons that support your message, etc. but do not clutter your slides with them; rather insert them in your speaking notes.
4. Introduce separate ideas, points with powerful images or quotations.
5. Ask thought-provoking or rhetorical questions: For instance, you could say "You might wonder why ..."; "When I started to look at this issue, I asked myself ..."; or "How much longer should we ...?"
6. Make startling (but realistic) statements to get and keep attention.
7. Be prepared for difficult questions: Consider all the objections the audience might have or questions they may raise about your points and information. Include the most critical ones within your presentation to sideline objections, or be prepared to answer them when they come up.
8. Have your own questions ready in case nobody asks one: leave time for questions and answers at the end. If nobody asks a question, be prepared with your own questions that you can then answer. Ease into them by saying something like "I'm usually asked..." or "One thing you might still be wondering about is ..."
9. Have a second short closing after the Q&A session, preferably without slide.

Source: Michel Theriault: 9 tips for more powerful business presentations. Forbes. Available from **http://www.forbes.com/sites/allbusiness/2013/11/04/9-tips-for-more-powerful-business-presentations/#32a2533843a0**.

Following the establishment of contacts and, ideally, a presentation to the company, the challenge for individual IPA officers is to develop and maintain relations with key decision-making staff in the company all the way into the post-establishment phase of the investment project cycle. These officers are the **account executives** for individual leads and play an essential role not only in attracting investors but also keeping them happy. In order to maintain these personal relationships, the account executive should:

- provide regular updates to stay in contact;
- manage and use his/her insight information as a result of his/her personal relation;
- listen carefully, act accordingly and keep promises;
- keep confidentiality, whatever he/she learns.

5. Summary of key investor targeting principles

The following best practice principles and elements for investor targeting can be identified:

- Focus on a small number of sectors and companies in each sector based on stringent qualifying criteria;
- If human resources are limited, focus on identifying key intermediaries (professional organizations) that can undertake investor targeting for the IPA (see e.g. **www.fdiprofessionals.com** for options);
- Focus resources, time and effort on multiple contacts in a small number of high quality prospects that are identified as strategic companies;
- Use trusted third parties for introductions and networking at the appropriate level;
- Attend industry events and trade conferences to identify potential leads;
- Develop a sales pipeline that can be re-activated and re-contacted;
- Targeting is only effective in combination with the right marketing tools;
- Develop a one-year marketing plan BEFORE engaging in company targeting activities;
- Ensure a consistent and coordinated approach among all team members to meeting with companies and making the presentation;
- Prepare proposition-based marketing materials and business cases tailored to a specific target audience;
- Develop research tools and questionnaire templates to be used when meeting companies;
- Understand that targeting is time consuming and labour intensive; it is not a one-time exercise and requires perseverance, patience, creativity and relationship building;
- Conduct a post-meeting evaluation and formulate immediate follow-up proposals to be made to companies;
- Pursue longer term follow-up and relationship building;
- Manage the sales process strategically with a web-based CRM system;
- Aim for a conversion rate of 20% on leads, prospects, and active cases;
- Apply a time limit/cut-off point on follow-up and closure.

G. DISCUSSION ISSUES

1. Does your IPA have an image building and/or investment promotion strategy? What is more important for your country/location: image building or active investment promotion and investor targeting?

2. Has your country/location a positive image with overseas investors? If not, what can you do to improve it?

3. If you have a concrete investment promotion strategy what is the objective of this strategy?

4. What are your most active investment promotion tools: brochures, newsletters, opportunity or sector profiles, investment roadshows and fairs, website? Any order of importance? What tool has proved the most successful in attracting FDI?

5. How do you generally consider the quality of your IPA or investment promotion website? Is there more than one website? Could the contents and lay-out of the website be improved? Does the website of the national level IPA differ from those of local IPAs?

6. Have you undertaken any evaluation of the use of the website and other investment promotion tools? What do investors think of your website and quality of other used tools?

7. Does your IPA engage in reactive or pro-active investment promotion? Considering all your investment promotion efforts, are they focused and cost-effective?

8. What is your experience with using social media for investment promotion purpose? How do see the role of such media for investment promotion?

9. Does your IPA engage in active sector/industry and company/investor targeting and profiling and lead generation? What database does your IPA use? Is this database of sufficient quality? How could it be improved? Are costs a constraint to do more investor targeting?

10. What sectors and companies does your IPA promote/target for FDI? Are these target in line with your countries: (a) needs: (b) competitive advantages?

11. What are your experiences with giving company presentations and following leads? Have they been successful? If there were failures what were the reasons for this?

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CHAPTER EIGHT

8 INVESTMENT FACILITATION

A. IMPROVING YOUR INVESTMENT REALIZATION RATE: INTRODUCING INVESTMENT FACILITATION

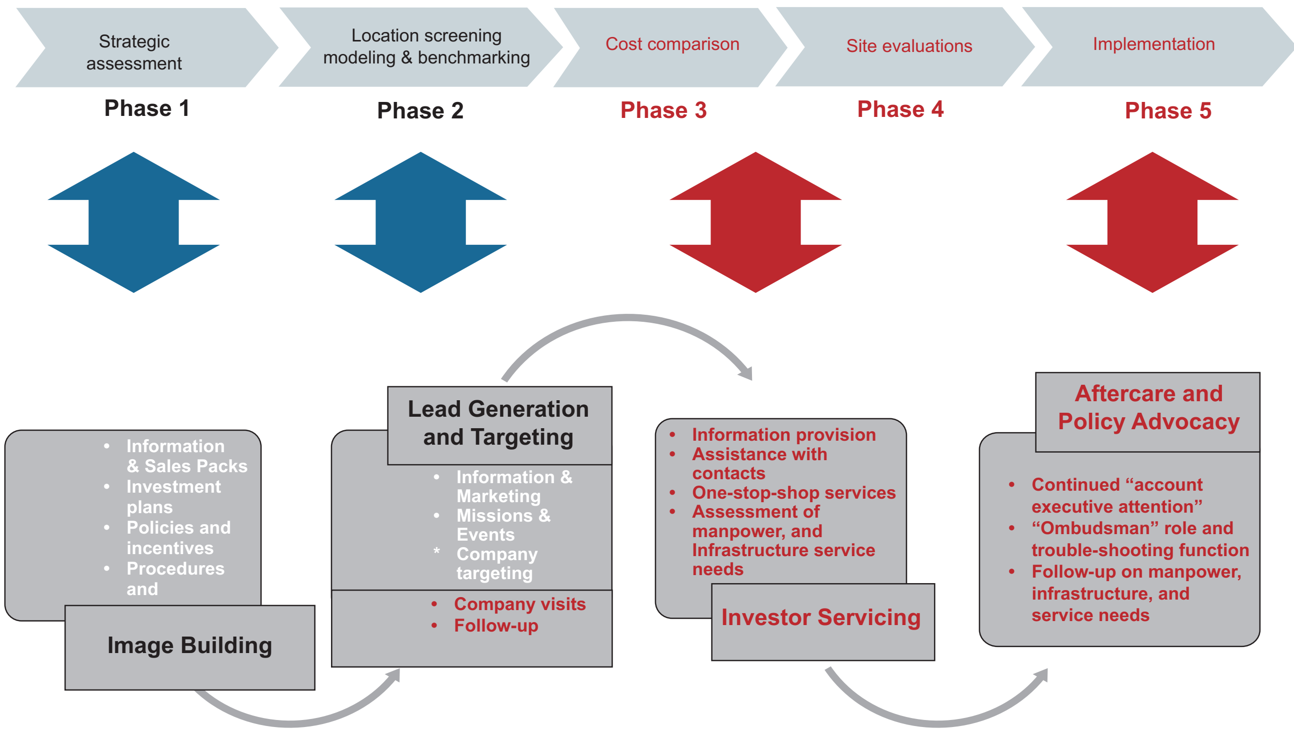
Investment promotion agencies and other agencies collecting FDI data and statistics usually present their FDI inflows on the basis of investment approvals. However, in many cases not all approved investment is actually realized. Sometimes there are gaps of 30-50%, which means that actual FDI may be less than half the total approved FDI (see e.g. for India: Nunnenkamp and Stracke, 2008; for Indonesia: Suleman and Iqbal, 2013; for Cambodia: Cuyvers and others, 2009). There may be various reasons for this gap such as regulatory and procedural obstacles in getting permits; lack of sufficient infrastructural facilities; non-cooperation from local government; problems with land acquisition/site clearance; problems with labour; problems with financing; problems with import clearance; corruption; inefficient IPA; absence of aftercare; lack of capacity of domestic partners; lack of capacity of investor; chance events such as natural disasters, conflicts, etc.

The way to close this gap is **investment facilitation** at all stages of the investment project cycle (figure 8.1) and investment promotion cycle (figure 8.2). Investment facilitation can be defined in various ways. UNCTAD (2016) distinguishes investment facilitation from investment promotion by referring to the latter as promoting a location as an investment destination (and is therefore often country-specific and competitive in nature), while the other is about making it easier for investors to establish or expand their investments, as well as to conduct their day-to-day business in host countries. According to VCC (2009), the aim of investment facilitation is to convert an investment inquiry into an actual investment. APEC (2008) defines investment facilitation as actions taken by governments designed to attract foreign investment and maximize the effectiveness and efficiency of its administration through all stages of the investment cycle. A World Bank report noted that an analysis of 30,000 high value-added FDI projects showed that investment facilitation, i.e. government-provided information and assistance, significantly influenced investor decisions to locate in one economy or another (World Bank Group, 2012).

Investment facilitation is the most basic and cost-effective activity supporting foreign investment promotion. **Transparency**, **simplicity** and **predictability** are among its most important principles (APEC, 2008). As stated by APEC (2008), "a sound investment facilitation strategy ensures that all investment applications are dealt with expeditiously, fairly and equitably. Investment facilitation also requires creating and maintaining transparent and sound administrative procedures that apply for the lifetime of the investment, including effective deterrents to corrupt practices. Finally, investment facilitation is enhanced by the availability of quality physical infrastructure, high-standard business services, talented and flexible labour forces, and the sound protection of property rights."

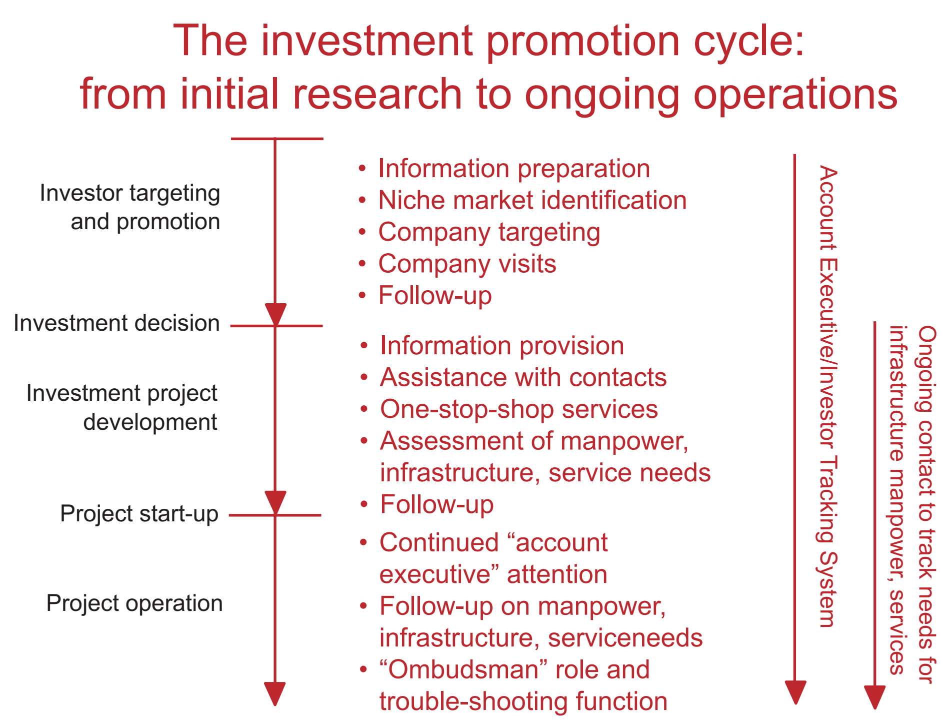
Therefore, investment facilitation plays a major role in every step of an investor's location selection and decision-making process. As shown in table 8.1, this involves facilitating access to all information a potential investor may need or requests to make a decision on investing in a particular location and helping the investor with preparing for and conducting the site visit (pre-establishment); helping an investor to realize the investment by assisting in getting him all the permits, licenses, approvals etc. (establishment), and helping the investor with addressing problems arising from the investment itself (post-establishment: aftercare). Active investment promotion basically only involves convincing an investor to invest (pre-establishment) while investment facilitation takes over at the establishment and post-establishment phases. In fact, best practices have shown that

Figure 8.1. The role of investment facilitation in the investment project cycle: where investors (clients) meet governments (IPAs)



Source: Investment Consulting Associates.

Figure 8.2. Investment facilitation is part and parcel of the investment promotion cycle



Source: ESCAP.

investment facilitation is the most important function of an IPA and often takes more time than investment promotion related activities.

Investment facilitation in the post-establishment phase is often overlooked, however. UNCTAD (2016) observes that between 2010 and 2015, at least 173 new investment promotion and facilitation policies were introduced around the world. However, almost half of these measures related to investment incentives, followed by special economic zones, and only 23% related to investment facilitation specifically. For many IPAs, once the investor has agreed to invest the job is considered done. This is a misperception. Investment facilitation in the post-establishment phase, or aftercare, has become instrumental to keep the investor happy and ensure that the investment is actually realized. Without investment realization, investment promotion is rather meaningless. Furthermore, happy investors are the best advertisement for any investment location and existing investors can act as ambassadors helping the country attract new investment. In the absence of proper aftercare, investors may be disappointed, discontinue the investment, leave the country and spread the bad news to other potential investors back home. Investment facilitation, in particular aftercare, is therefore an essential part of investment promotion and the IPA should provide adequate facilities and resources for this purpose.

The goal of investment facilitation is therefore to facilitate initial investment, retain that investment, and expansion of existing investment. It is to **increase the satisfaction of investors** (the IPA's "customers"). Table 8.1 gives an overview of the most important aspects and activities involving investment facilitation throughout the investment promotion cycle.

Table 8.1. Investment facilitation throughout the investment promotion cycle

Investment promotion stage	Investment facilitation activities
Pre-establishment (focus on active investment *promotion*).	• Provision of all required and relevant information to the investor to "facilitate" the decision of the investor in favour of the host location; • Setting up meetings as required with potential customers, government agencies etc.; • Preparing for and conducting the site visit.
Establishment (construction) (focus on investment *generation*).	• Act as "one-stop shop": helping with obtaining investment license: construction, work and residence permits, access to land and buildings (lease, purchase of properties), labour, finance, etc.
Post-establishment (aftercare) (focus on investment *facilitation*).	• Troubleshooting problems encountered by investors during production, e.g. with labour, utilities, permits etc.; • Managing inspections; • Managing (minimizing) other bureaucratic harassments and corruption.

Source: ESCAP.

Investment facilitation entails some key aspects which IPAs should carefully consider:

- Investment facilitation entails the entire project cycle, from initial inquiry to aftercare services;
- Keep a service mentality at all times, and bear in mind that the investors are your customers;
- Good preparation is critical for successful meetings with investors;
- Problems should be detected at an early stage: this can only be achieved through proactive contacts with investors from the beginning;
- Problems or requests for information or assistance should be dealt with in a timely manner;
- Recognition should be given that start-ups need more sustained help, and that smaller firms have different needs and capabilities than large TNCs;
- Regularity of contact with investors, at least the major ones, is critical;
- Services should be somewhat personalized rather than institutionalized, along the lines of the "account executive" approach;
- The IPA must be closely networked with private sector and other government agencies to provide investors with a variety of contacts and to assist investors in overcoming bureaucratic hurdles and related obstacles.

IPAs need to understand that they are a service provider and the investors are their customers. They therefore should adopt a strong customer service mentality and attitude. They need to do their homework and be prepared when they meet investors. They need to know the background of the investor companies, what needs these companies have, and what stage of the investment cycle they are in. IPAs need to use an investor tracking system to keep track of developments. Investors are operating in a foreign country and likely cannot resolve problems on their own as easily as back home. The faster IPAs can provide them with the accurate information (or problem solving) they need, the more satisfied they will be. IPAs need to be there for the investor throughout the whole investment cycle, from initial inquiry to providing aftercare services.

A World Bank paper (Ortega and Griffin, 2009) referred to the Global Investment Promotion Benchmarking 2009 Report which found that more than 70% of IPAs failed to provide effective investment facilitation services to investors, i.e. provide investors with accurate and timely information. The paper noted that investment facilitation is one of the simplest and most cost-effective functions, yet it is neglected at many agencies. A survey by the Investment Climate Advisory Services of the World Bank Group identified 14 common practices of the top-performing agencies in the benchmarking study. Weaker performers can inexpensively implement many of these practices to win a larger share of the trillion-dollar market for foreign investment. Box 8.1 lists the 14 practices.

Box 8.1. 14 common investment facilitation practices

Foster a private sector-minded culture

1. Recruit and train staff with public and private sector experience.
2. Offer salaries and bonuses closer to private sector standards.
3. Secure operational freedom and high-level reporting channels.
4. Establish and concentrate efforts in a few priority sectors.
5. Coordinate facilitation with networks and partners, subnationally and overseas.
6. Maintain English-speaking staff in sufficient numbers and with the full range of facilitation skills.
7. Continually train and develop staff, especially in soft skills.

Accumulate deep business knowledge

8. Establish a minimum level of in-house research capacity.
9. Develop account managers into reservoirs of knowledge on particular sectors.
10. Ensure the accumulation of knowledge and its relevance.

Implement internal systems for consistently good facilitation

11. Make facilitation a priority within the overall strategy, including by training and dedicating an adequate proportion of staff.
12. Maintain the equipment and practices to be easily reached and to quickly return calls and e-mails.
13. Demonstrate professionalism and dynamism through the website with frequent news updates of importance to investors.
14. Follow detailed guidelines on the content, style, timeframe, and quality assurance of inquiry responses.

Source: Ortega and Griffin (2009).

UNCTAD (2016) takes a broader policy approach towards investment facilitation and presents a Global Action Menu for Investment Facilitation. The Menu seeks to complement existing investment policies. It therefore excludes policy measures aimed at the protection of investment, which are well-established in the existing national regulatory frameworks and IIAs. Similarly, it does not propose direct investment support measures such as guarantees or incentives. The Menu proposes 10 action lines with a series of options for investment policymakers and government agencies for national and international policy measures: the package includes actions that countries can choose to implement unilaterally and options that can guide international collaboration or that can be incorporated in IIAs. The Menu is based on UNCTAD's Investment Policy Framework for Sustainable Development. The Global Action Menu can be accessed at **http://investmentpolicyhub.unctad.org/Upload/Documents/UNCTAD.GlobalActionMenuForInvestmentFacilitation.v4.16.09.2016.pdf.**

B. PREPARING FOR AND CONDUCTING THE SITE VISIT

1. Preparing the site visit

Investment facilitation at the pre-establishment phase is mostly about providing accurate, timely and up-to-date information to potential investors, in particular information about the overall investment climate and possible locations and sites in the host country of the IPA. However, potentially new investors do not make a significant investment based on desk research and benchmark studies only. They need to verify and validate the data and analyses with site visits, which are a mandatory exercise to make a well-informed investment decision. Therefore, once the investor has expressed a clear interest in a particular location/site, the next important aspect of investment facilitation is preparing for and conducting the site visit.

A site visit is a tailored programme for an investor that allows the IPA to showcase the local and regional business climate and available investment opportunities and facilities. This means that site visits are an excellent opportunity to positively influence the decision-making of potential investors. However, at the same time the organization of a site visit requires a lot of time and resources. An IPA, typically a local IPA or local IPA branch, should only consider organizing a site visit if it is in response to an official investment inquiry or investment proposal of an investor. The organization of a site visit is part and parcel of the pre-establishment investment facilitation role of an IPA.

Potential investors need to actually inspect the investment location in detail and the IPA should act as their investment guide. If a proposal and overall professional approach adopted by the IPA convince an investor that the IPA can realize a project faster than its competitors, it is more than half way to winning the project. A strong coordination during the site visit with introductions to relevant organizations, individuals and other investors can be crucial in winning an investment. The IPA needs to know who will make up the site visit team, most likely senior officials in the company, and possibly official who may be based in the location where the new investment is to be made. In particular, the team may consist of:

- **Senior manager** with project team oversight;
- **Human resources manager** – will assess all aspects of the labour market and education system;
- **Operations manager** – will assess all operational aspects;
- **Real estate/facilities manager** – will evaluate all real estate issues including logistics and equipment access;
- **Information and communications technology (ICT) manager** – will need to understand all connectivity, telecom, power, and equipment-related issues;
- **Security manager** – will assess risk to company employees.

The more relevant and detailed information the IPA can gather to meet investor needs in advance the better it is in a position to properly prepare for and tailor the site visit in accordance with the investor's needs. For instance, the IPA may need to know about the investor's requirements on:

- Location (big city, industrial area, close to ports, etc.);
- Site (SEZ, inside the city, outside the city, close to suppliers etc.);
- Premises (availability of plant, warehouse, etc.);
- Human resource;
- Logistics and utilities, energy;
- Link to suppliers (time and distance);
- Link to markets: wholesalers/retailers/consumers (time and distance).

It is important that the IPA is pro-active and anticipates investor needs so that it is not stranded for an answer or caught empty-handed when the investor delegation arrives with particular queries or requests. For a start, the IPA may wish to find out how the site selection in the investor company has taken place on the basis of what criteria. Often, the site selection is conducted by consultants, e.g. a leading accounting firm; engineering, value broker, architect or real estate broker firm; professional site consultants, special in-house project teams, top management, international business associates or existing representative offices of the investor already present in the host country (which would demonstrate the interest of the investor in the host country). The IPA also needs to find out about the purpose of the site visit. It is likely that many investors have probably been to the host country before.

Depending on the objectives of the site visit, IPAs need to gather the relevant information beforehand to anticipate investor needs and queries. Information may be required with regard to the quality of industrial parks, accessibility to and quality of infrastructure, availability and cost of human resources, available incentives, suppliers, markets, etc.

At the phase of site visit, investors typically use a site selection matrix to evaluate a location. Most investors systematically evaluate the attributes of the candidate locations in terms of specific, detailed criteria using a site selection matrix which is identical but more detailed than a general benchmarking exercise (see chapter 7). Thus, such a matrix can also be used as a checklist for IPAs to prepare for the visit. By assigning these criteria numerical weights, the more important factors play a more influential role in a location's final "score", which vary depending on the type of company. IPA needs to know what the company is looking for in order to estimate the weights investor would use. In the evaluation, the competing locations are examined in terms of these criteria and compared across categories including market dimension, manpower availability, return on investment, etc. Table 8.2 shows an example of a site selection matrix. In the end, the location with the highest "score" will most likely secure the investment. If the scores are relatively similar, the quality of service provided by the IPA can be critical in tipping the balance in favour of that location. The matrix will enable IPA to identify its location's comparative strengths and weaknesses prior to a company visit. While an investor is likely to discuss the weaknesses during the visit, anticipating the matrix would help IPA prepare a response to any identified weaknesses, such as pointing out the corrective actions that are underway or planned (World Bank/MIGA, 2000).

Table 8.2. A sample site selection matrix

Categories	Weighting	Location A (IPA host country)	Location B	Location C
Market dimension (e.g. size of market and market access, etc.).				
Manpower availability (e.g. skilled labour, managers, % of unionized labour, skill levels, etc.).				
Return on investment (e.g. political and economic stability, corporation tax, incentives, inflation and bank rates, labour costs, cost of living, etc.).				
Property (e.g. site costs and areas, production space, building and rental costs, property taxes, etc.).				
Business environment (e.g. cultural, work ethic, prevailing local government procedures and regulations, SEZs, etc.).				
Productivity measures (e.g. output per employee, GDP/capita, gross value-added per employee, etc.).				
Customs regime (e.g. inward processing relief, import duties and procedures, time for import clearance, etc.).				
Value chain (e.g. ease of accessing parts and components, subcontracting to local enterprises, distribution network).				

Table 8.2. *(continued)*

Categories	Weighting	Location A (IPA host country)	Location B	Location C
Education/R&D (e.g. universities, no. of graduates, advanced engineering, available software and R&D institutions, etc.).				
Utilities (e.g. availability and costs of electricity, water, gas, etc.)				
Transport (e.g. availability and quality of roads, railroads, ports and airports and associated costs).				
Telecommunications (e.g. availability of phone and mobile phone networks and costs, Internet connection and quality, etc.).				
Project management (one-stop shop services provided by IPA).				
Quality of life (e.g. cost of living, availability of nearby quality medical care, schools, entertainment, etc.).				

Source: World Bank/MIGA (2000); Appendix I.

IPAs further need to set up a programme of meetings with local industries and service providers which investors may wish to meet, such as recruitment agencies and real estate brokers, accountants and lawyers. Meetings can also be arranged with existing investors, potential local suppliers and customers and relevant government agencies/departments, either at central or local level or both, including customs or tax offices. Investors may also wish to meet local embassy staff (box 8.2).

Box 8.2. Preparing and conducting site visits: whom to meet? A sample

- Important existing investors (from same industry or same country as visitor);
- Embassy officials of the investor's country;
- Potential local suppliers for that company;
- Potential key customers for that company;
- Executives of the CCI and other business associations
- Executives of foreign business associations or groupings;
- Senior central and local government officials (for major investors only);
- Tax office;
- Customs;
- Airport, railway officials (for major exporters);
- Relevant regulatory agencies for a particular sector;
- Lawyers;
- Accountants;
- Engineering firms;
- Manpower providers;
- Real estate agents/industrial estates/SEZs;
- Technical colleges and labour training facilities;
- Business consultants;
- Market research services.

Source: Investment Consulting Associates.

The IPA should assign one officer to manage the entire visit ("account executive" approach), so that the prospective investor knows exactly who is handling the visit, can address all requests to that person, and there is clear accountability for the site visit. If the visiting company is a major one, a senior IPA official ought to manage the site visit to emphasize the importance of that particular investor.

The key points to consider by the IPA when planning a site visit include:

- **Knowing the company well**, its products, requirements, export shares, presence in countries, role in supply chains, partnerships, responsible business practices, etc.
- Appointment of a **project manager** fluent in the investor's or English language (account executive) to manage the entire visit (and all required follow-ups all the way through establishment and operations);
- Agreement on the **dates and itinerary** the company would like to visit (avoid public holidays in home and host country);
- Agreement on the **key objectives** of the visit;
- Ascertaining the **detailed information** required on the property or site the investor is looking for and other critical information the investor would like to gather (use measurements the investor is familiar with);
- Finding out the **timeframe** for deciding when to invest/start date and value of the investment;
- Knowing **who from the company** will be attending, their positions, roles, etc.;
- Finding out **which organizations the company would like to meet**;
- **Information on delegation members** and possible spouses: names, contact details, religious issues, diets, preferences, etc.
- Prepare for **"handholding"** especially for first term investors and investors from smaller companies; anticipate language barriers.
- **Mix business with pleasure**: invite investor to a local restaurant, cultural show etc.;
- **Anticipate difficult questions** and be **aware of competing locations** and their strengths, weaknesses.

2. Conducting the site visit

The site visit should take place on the basis of a carefully prepared schedule which accommodates the investor's requests. Meetings should not be hurried so ample time for each visit should be allocated. The following points need to be carefully considered by the IPA and individual account executives in conducting the visit:

- Ensure that there is a carefully worked out and agreed programme (by IPA and investor and persons/ institutions to visit).
- Ensure that the investment officer is thoroughly conversant with the programme, the places that will be visited, and the people who will be interviewed. Foreign language skills may be required.
- Ensure that the transport person/driver is familiar with the locations that will be visited.
- Ensure that the client is fully briefed before the site visit begins.
- At the beginning of the visit, conduct an introductory session for the prospective investor about the country/province, the investment and economic environment, and the roles and services of the IPA. However, if such a presentation was made during a visit to the company before there is no need to duplicate.
- Presentation should be made by a senior official from the IPA.
- Information presented should be relevant and tailored as much as possible to the visiting company representatives' needs and sector interests.
- Host a wrap up meeting to review the outcomes of the site visit, address any remaining concerns that the investor has about the country/province/location or the investment project, and identify any remaining information needs that the investor requires to make a decision.

Site visits can fail on the basis of overlooked details that matter, such as qualify of life issues (box 8.3). Rapid post-visit follow-up is critical for landing the investment. In particular, it shows the commitment and credibility of the IPA, and can often make the difference in which location the investor chooses if there are competing locations. The site visit manager should work immediately on gathering the additional requested information, particularly if it must come from another agency. The IPA should provide the additional information/ documentation before the deadline agreed upon with the prospective investor and should notify the prospective investor of any new developments related to the visit since the company representatives departed. If no additional information is required, the IPA should contact the investors at regular intervals (but not too often).

Box 8.3. The site visit: quality of life matters

- Every investor will also be evaluating the 'Quality of Life' of a location as part of the process – they may be sending executives with families to live there.
- Be prepared to answer questions on security, education, housing, medical care, and whether they can bring the family's dog with them.
- Tour cultural and recreational centres if there is time.
- Arrange 'off time' and host them to a traditional meal in an authentic restaurant (but be aware of dietary requirements of the visiting group).
- Mix business with pleasure where possible – show them that it will be a fun and interesting location to operate from too!

Source: ESCAP; Investment Consulting Associates.

C. INVESTMENT FACILITATION: ESTABLISHMENT PHASE

The IPA has scored a hit! A major investor has agreed to set up a manufacturing facility in a particular location. Investment promotion has finally paid off. However, the IPA may still risk losing the investment if it does not carefully guide the investor through the establishment phase. If left to its own devices to manage the establishment, investor may be put off by the many requirements and pull the plug of the investment. During the establishment and post-establishment stages, the IPA is no longer doing investment promotion but only investment facilitation. This role is therefore essential. Table 8.3 lists some of the establishment requirements which require the assistance of the IPA. Box 8.4 also discusses some of the requirements associated with project establishment.

Table 8.3. Establishment stage issues for foreign investors

Entry approvals	Land and site access and clearance
• Visas and stay permits;	• Access to state land;
• Company registration;	• Town planning certificate;
• Investment project registration;	• Site inspections and general approvals;
• Initial bank deposit;	• Building permits;
• Residence and work permit;	• Electricity and power connection;
• Tax office registration;	• Telephone, telex and Internet
• Foreign investment licensing;	• Water and sewage;
• Business and trading permit;	• Customs;
• Statistical office registration;	• Post box.
• Health care and pension plans;	
• Social security registration.	

Source: Morisset and Neso (2002).

Given the special requirements for effective investment facilitation, many IPAs have established a specialized **investment services centre (ISC)**. Such a centre is normally attached to or part of the IPA as a department or unit and sometimes as a stand-alone facility, in particular in locations away from the capital with a significant number of investment projects. In any case, an ISC is set up to undertake the following activities:

- Pre-investment counselling;
- Business visit facilitation;
- Information and market research;
- Business partner identification and matchmaking;
- Coordination of investment approvals and incentives;

Box 8.4. Establishing an investment project in a new country/location

When trying to establish an investment project and making it operational, investors tend to face a myriad of steps where they need to interact with various government agencies to obtain all the necessary permits, licenses, approvals and clearances. As a first step, a potential investor needs a visa to enter in order to explore the country as a potential investment location. Having developed an interesting investment project, in some cases a foreign investment and/or general industrial license needs to be obtained. Sectoral or industry-specific licenses are generally required before operations can be initiated. The new company needs to be incorporated and registered. The paid-in capital often needs to be valued when in-kind and certified. Tax authorities need to register the company. Registration approval procedures need to be completed with finance, banking and trade authorities in cases involving foreign exchange and export/import transactions. Central, regional and provincial authorities have to clear access to land and approve the construction and occupation of production facilities. For the hiring of domestic and foreign workers, approvals need to be obtained from labour and immigration offices. Clearances and inspections are required from a number of authorities, including environment, health, safety and labour. In short, an investor has to be in contact with a number of different government authorities to go through their administrative procedures before operation can begin. A delay in any of these steps will translate into additional costs and foregone revenue, and any permit, approval or clearance not forthcoming can jeopardize the entire project.

Source: Al-Fattal (2008).

- Ongoing red tape "trouble shooting";
- Assistance in mobilizing finance;
- Investor follow-up and aftercare.

In particular, ISCs have the following functions:

- Receive visitors, including scheduled visitors and unscheduled walk-in visitors;
- Provide basic information and advice about the range of services and advice that the IPA can supply, including matchmaking services in many cases;
- Answer routine e-mail and telephone inquiries requesting information;
- Provide the necessary official forms and contacts that any investor needs to set up a business in that country;
- Assist investors in accessing information on the IPA, other government agencies (often representatives from these agencies are stationed in the investment service centre), and useful websites;
- Assist investors in solving problems related to doing business;
- Put investors in direct contact with the relevant IPA or other officials when a particular question cannot be answered on the spot, or when a specific problem cannot be dealt with immediately by the investment service centre staff;
- Alert IPA colleagues about deficiencies in the "off the shelf" or "off the web" information available in response to frequently asked questions;
- Locate and provide information for potential investors;
- Perform specialized searches for information not readily available to others;
- Matchmaking.

Another important function of ISCs can be *matchmaking* – the promotion of joint ventures, technology transfer, outsourcing arrangements and other types of competitiveness-enhancement investment. The major aim is to encourage a flow of productive new FDI into manufacturing and service industries. Matchmaking involves marketing prospective local opportunities to overseas firms. Much of the work involves locating interested and suitable investment partners for overseas firms. This requires a good network with firms to conduct outreach and establish a close working relationship with individual enterprises. Matchmaking is especially useful for efficiency- and strategic asset seeking FDI (M&As). Matchmaking is a grey area that touches both upon investment promotion (attraction of new investment) and investment facilitation (finding partners for prospective new investors in the pre-establishment phase). IPAs can choose to have separate aftercare and matchmaking centres (see chapter 3 for examples).

A true investment facilitation job is navigating the bureaucracy and acts as a “one-stop” shop (OSS) to get all required permits and licenses for the investor. These may include visas and stay permits; work permits, factory licenses, company registration, hiring local labour, site clearance and any other permits, which, in some countries, may even involve a permit that allows you to buy and drink alcoholic drinks!

There are various types of OSS, including “one-door” (all government agencies represented in one location), “one-window” (one agency having authority to accept applications for permits from all other agencies/ ministries) or “one-portal” (online single window), ideally providing an integrated service facility (Daniel and Forneris, 2010). In practice, the notion of a “one-stop” shop seems to be rather elusive (box 8.5).

IPAs worldwide are increasingly trying to provide OSS facilities with varying degrees of success. It is important that ISCs provide quick and efficient assistance to investors in sorting out the requirements and issues listed in table 8.3. This means that IPAs should pro-actively identify immediate and future needs, in particular in the areas of infrastructure, manpower, support services, customs services and feed the information to respective agencies to ensure their immediate response to address investor needs. Best practice OSSs are difficult to find. In the Asia-Pacific region, the services of Invest in Taiwan (**http://investtaiwan.nat.gov.tw/**) and Singapore’s Economic Development Board **(https://www.edb.gov.sg/content/edb/en/why-singapore/ready-to-invest/ setting-up/entering-singapore.html**) are routinely cited as good examples. Box 8.6 describes the services of the recently one-stop (one-door) service centre of BKPM Indonesia.

Box 8.5. One-stop shop for FDI establishment: myth or reality?

In its narrowest definition, an OSS would effectively mean that one government agency has the authority necessary to grant all licenses, permits, approvals and clearances. Without such an all-embracing authority, the agency could in fact not wield much control over the process. It could therefore not actually provide all the necessary clearances at various stages of the administrative process, having to depend on other authorities instead.

In practice, however, such an idealistic notion of the OSS has proven unrealistic. Practically all governments that tried to implement this form of an OSS encountered significant resistance by the various government agencies responsible for the different administrative procedures. Most importantly, other ministries and agencies fear that the creation of such an OSS would result in curtailing their authority and mandate, quickly leading to intensive turf battles within the government bureaucracy.

More relevant is the question whether a single agency should actually have this much authority and power. It is important to recognize that most agencies and administrative processes were created in response to particular policy concerns of the government. Be it concerns related to immigration, environmental degradation, tax evasion or health and safety problems, each agency tries to address a particular issue with specialized staff and processes. Any OSS that wants to provide qualified authorizations in any of these areas would in fact have to re-build these (or similar) structures in-house. Otherwise approvals such as environmental impact assessments, VAT reimbursements or health and safety certificates would most likely not meet the underlying policy objectives. But such a mirroring of administrative capabilities would quickly turn an OSS into a bureaucratic super-agency with massive staff and resource requirements. It is unlikely that any such agency would be capable of providing fast and client-oriented services to the private sector.

Governments therefore typically shy away from establishing such an OSS in the narrow sense. Instead they tend to rely on some form of coordination mechanism where the various authorities maintain their existing mandates and responsibilities. The typical structure of such a coordinating mechanism consists of the delegation of staff from the various ministries and agencies to establish their offices in the same location, frequently an IPA.

In practice, the OSS is simply a mailbox operation, where the investor submits his paperwork just to pursue it directly with the relevant authority in order to see his application through. Lall (2000) notes that “unless the agencies have the authority needed to negotiate the regulatory system, and unless the rules themselves are simplified, there is a very real risk that a ‘one stop shop’ becomes ‘one more stop’”.

Source: Al-Fattal (2008).

Box 8.6. One-Stop Service Centre of BKPM Indonesia

Badan Koordinasi Penanaman Modal (BKPM) is the Investment Coordinating Board of the Republic of Indonesia. As the primary interface between business and government, BKPM is mandated to boost domestic and foreign direct investment through creating a conducive investment climate. Restored to Ministerial status in 2009, and reporting directly to the President of the Republic of Indonesia, this investment promotion agency's goal is not only to seek more domestic and foreign investment, but also seek quality investments that improve social inequality and reduce unemployment. The BKPM also provides services to help local and foreign investors do business in Indonesia and useful administrative and compliance information, as well as sectors and opportunities details.

In January 2016, BKPM launched the one-stop (one-door) integrated service (PTSP) of BKPM in response to the presidential instruction to create a business-friendly bureaucracy by eliminating costly red tape for entrepreneurs and investors. While similar one-stop services existed before, this is the first time a fully integrated service is provided. The BKPM unifies licensing services in 22 government institutions that were previously run separately with each institution posting an official at the PTSP.

Two licensing services are provided: investment licensing and product licensing. The three-hour investment licensing service requires a minimum investment of Rp100 billion, and/or the absorption of 1,000 workers. The investment licensing service for foreign investors includes the issuance of an investment license, deed of establishment and approval, tax registration number, certificate of company registration, foreign workers recruitment plan, work permit, importer identification number, customs registration number and letter on land availability. Before it could take up to 11 days to obtain these documents from various institutions. The Service covers all sectors except for banking and upstream oil and gas. The service employs 77 liaison officers from the 22 ministries/government agencies. The front desk liaison officers accept documents and give consultations to investors. The received documents are followed up by the back-office liaison office, which processes all the documents.

In order to support transparency in PTSP, BKPM has built an online monitoring service, which can be used by investors to monitor progress of their business license application and to make sure that the deadline completion is in accordance with standard operating procedures that have been set. To facilitate investors in obtaining information and filing for complaints, BKPM also provides a contact centre by phone which can be contacted by investors for 24 hours, 7 days a week.

Source: Available from **https://www.amcham.or.id/fe/4882-bkpm-launches-one-stop-service**; **http://www5.bkpm.go.id/en/home-investment**.

Other support services required from IPAs and their ISC during the establishment phase include:

- Ongoing trouble-shooting:
  - With utilities; on regulatory matters – customs clearance, hiring of labour, taxation, immigration, etc.;
  - Resolving inconsistencies of local procedures with national legal framework;
  - Coordination among local agencies.
- Actively building networks of investors:
  - Investor meetings;
  - Meetings of industrial zone/SEZ tenants (if relevant to the location);
  - Meetings of chambers of commerce and other industry association
- Provide value-added services:
  - Supplier identification (e.g. BUILD in Thailand, see box 3.11 in chapter 3);
  - Partnership building and matchmaking;
  - Coordination of access to non-IPA services:
    - finance;
    - export information;
    - technology support programmes;
  - Assistance with expansion plans.
- Continuation to act as an "account executive":
  - Tracking and monitoring project;
  - Actively identifying and implementing solutions.

There is no uniform prescription of an effective ISC but certain key success factors can be identified (table 8.4.).

Table 8.4. Key success factors for an effective ISC

Show high-level political support.	Centre must have commitment from head of the IPA and other government agencies to enable it to conduct its work effectively.
Use the account executive investment facilitation model.	Assign an officer to each investor to help ensure consistency, knowledge about the client's history and current status, and status, and create sense of responsibility.
Provide intensive training for each account executive.	Each account executive should go through a systematic training process about investment rules and regulations, the IPA's processes, and client service techniques.
Designate appropriate liaison staff at each relevant agency.	Identify a willing and knowledgeable focal person at each relevant agency to serve as the main point of contact for the IPA in the event of investor problems or information needs.
Provide training to other agencies.	Help the other government agencies understand what your ISC is attempting to do and how it works. Provide clear suggestions on how other agencies can assist the Centre.
Form a high-level committee/dispute resolution body (for when inter-agency disputes occur).	In the event of a dispute between the IPA and other agencies (or among other agencies in the interpretation of investment regulations), there is a need to have a body for resolving these matters quickly and objectively.
Use ongoing performance measurements for staff/account executives	Have established standards to measure their performance. Must ensure that the officers understand these standards. Track how long various procedures take to be completed for the investors they are assigned to support.
Undertake a publicity campaign to increase awareness of the importance of investors.	The message must be communicated that investors are important to the country and local communities, and that they deserve high quality services and support from all related government agencies.
ISCs must be transparent and consistent with their services and charges (if the latter apply).	Satisfied investors will lead to greater public benefits for all.

Source: Investment Consulting Associates.

D. POST-ESTABLISHMENT INVESTMENT FACILITATION: AFTERCARE

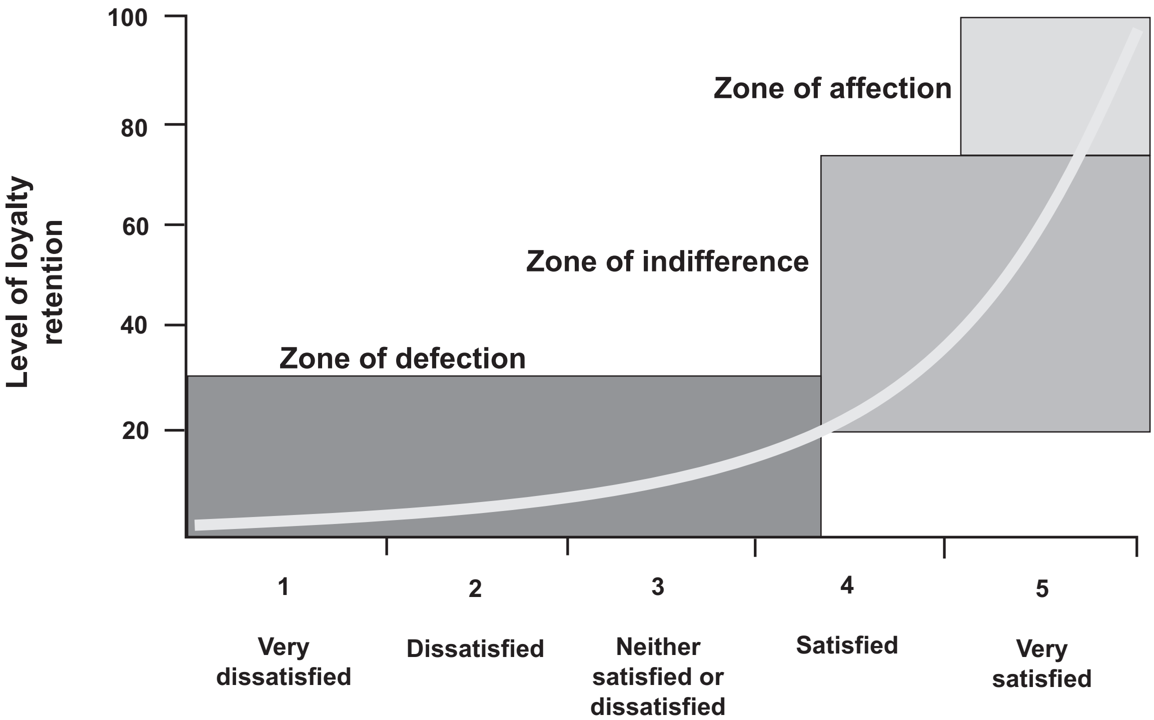
1. Rationale for aftercare

The main activity of investment promotion traditionally is to attract new investors, while with an increasing number of established foreign affiliates new investment can be realized through investor aftercare – a more cost-efficient activity (UNCTAD, 2008). This section analyses this core function in investment promotion/facilitation.

Aftercare is defined as comprising all potential services offered at the company level by IPAs, designed to facilitate both the successful start-up and continuing development of a foreign affiliate with a view toward maximizing its contribution to local economic development and to ensuring the success and sustainability of the company's investment (Young and Hood, 1994; VCC, 2009). UNCTAD (2007) defines aftercare as "the range of activities from post-establishment facilitation services through to developmental support to retain investment, encourage follow-on investment and achieve greater local economic impact". Aftercare is the investment promotion equivalent of customer care and relates to proactive management of existing investors. It plays an important role both in **investment retention** and in **investor development** which helps investors proactively to grow. Investment retention is a short-term concern based on the perception that a significant share of FDI is actually re-investments. Investment retention has become particularly important in the wake of the global economic crisis which witnessed sharp drops in greenfield FDI across the world. Investor development takes a long-term strategic view that growth of existing investment will ultimately lead to more jobs and economic growth.

Thus, the principal purpose of aftercare is to build investor **confidence**, **trust** and **loyalty** (figure 8.3). The idea is to create customers (investors) who display such a high level of satisfaction and loyalty that they become **"apostles"**, i.e. ambassadors for the host country/location and a principal marketing tool for the IPA.[134]

Figure 8.3. The role of investor aftercare in generating investor satisfaction and loyalty



Source: Heskett and others (1994).

The principal rationale for aftercare can be summarized by the C.R.E.E.D. principle:[135]

- **Consolidate**: improve low implementation rates;
- **Retain**: keep existing investors from leaving;
- **Embed**: extract benefits for development;
- **Expand**: get reinvestments;
- **Diversify**: support opportunities for other, higher value business activities.

According to UNCTAD (2007, 2008), a survey of 69 IPAs illustrates the untapped potential of aftercare. The responding agencies devoted on average only 10% of their resources to aftercare activities, while 84% of the IPAs stated that aftercare had higher or equal priority to other activities for generating reinvestment or expansion of existing activities, and 32% of all inward FDI was estimated to come from reinvestment.

These aftercare services include both post-establishment facilitation services to improve the implementation rate of investment projects and follow-up investment to enhance the development impact of the investment (Loewendahl, 2001). Around the world, many of the largest and most strategic projects are expansions by existing investors. Some experts estimate that, especially in developed countries, up to 70% of investment is linked to the existing investment base (UNCTAD, 2007). Aftercare has gained in importance in IPA's activities over the last decade (see box 8.7 for the case of the Philippines).

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[134] The term "apostles" was first introduced by Scott D. Cook, CEO of Software producer and distributor Inuit.

[135] Available from **https://prezi.com/mpixn0dfthis/how-to-develop-after-care**.

Box 8.7. BOI Philippines Strategic Investor Aftercare Program (SIAP)

In early 2008 the BOI Philippines launched the Strategic Investor Aftercare Program (SIAP). The programme was designed to build longer-term relationships with strategically important existing foreign investors and to gather intelligence supporting the country's investment climate reform agenda. The programme is implemented by the Investment Assistance and Services Department (IASD). The Investment Climate Advisory Services team of the World Bank Group has offered support in the programme design.

Objectives

- Establish lasting partnerships and foster effective and sustained interaction with the investors;
- Update investors on the latest BOI policies and information related to their business;
- Facilitate the expeditious resolution of issues/concern raised by the investors;
- Assess on future assistance that a firm may need.

Services

- Regular visits to BOI-registered firms;
- Practical business advice;
- Issues and concerns facilitation;
- Updates on investment policies, rules and regulations;
- Investors participation through feedback/suggestions;

Benefits

- Provides immediate and quick resolutions to issues raised by the investors pertaining to their business concerns;
- Establishes valuable business contacts, investors are linked up with proper authorities, and facilitate the investor's current business concerns;
- Offers investors practical options to re-invest, expand or diversify their business.

BOI also runs IPU Net, which is a collaboration of 28 government agencies that signed a Memorandum of Agreement to act immediately and resolve the difficulties encountered by investors in operating their business. As the secretariat, the BOI dispatches and monitors investor concerns and tracks the progress of each case. Investment-related complaints involving violations of commitments/roles of the IPU Net member agencies are acted upon by the Office of the Ombudsman (OMB).

A survey conducted in 2014 indicated that investors were satisfied with the programme – they gave a 96.5% satisfaction rating to SIAP.[136]

Source: Invest Philippines. Available from **http://investphilippines.gov.ph/setting-up/investors-aftercare**.

The business case for providing an aftercare service is that (UNCTAD, 2007; VCC, 2009):

- Existing investors are a "captive audience" – quicker and generally easier to attract new investment from. "It is seven times more expensive to land a new customer than it is to sell to an existing one." (World Bank/MIGA, 2000).
- Aftercare is less costly than attracting new investors, as there are lower sales, marketing and travel costs.
- The satisfied TNC will do the marketing for the IPA and can act as an investor ambassador for the host country.
- It stimulates second generation activity – expansions, broadening and deepening.
- It can lead to economic growth among local suppliers.
- It prevents investor-state disputes.

[136] Manila Times, 12 September 2014. Available from **http://www.manilatimes.net/bois-aftercare-program-gets-96-5-rating-investors/126234**.

There is a clear economic development case for aftercare as well:

- **Short-term benefits:**
  - Support investors to realize their initial investment plans.
- **Long-term benefits:**
  - Aftercare as an important component of more fully integrated local economic development (e.g. flagship investors that have been granted responsibility for product-related R&D such as Apple and Intel in Ireland);
  - Continuous upgrade of existing investment and factor conditions (national competitive advantage);
  - In particular infrastructure and labour development benefits;
  - Emergence of suppliers and service providers in the location.
- **Wider policy benefits:**
  - Lower cost and improvement of the reliability of public services;
  - Potentially important channel for investor views and opinions to reach top levels of government;
  - Government policy can benefit from aftercare relationships as sources of intelligence on key trends and issues.

2. Delivering effective aftercare services

Aftercare is now regarded as a vital service to maximize the value of FDI, and a key programme element for virtually all successful IPAs. Effective delivery of aftercare requires a thorough understanding by the IPA and a designated account executive of the investor and his/her strategic plan for expansion. In essence, this is how an IPA can incorporate some of the best practices in aftercare services (VCC, 2009):

- Frequently visiting investors;
- Taking a proactive, not reactive approach;
- Focusing on company growth and maximizing opportunities, not just problem solving;
- Taking a coordinated, long-term view that involves all key players;
- Targeting specific companies – not approaching comprehensively all investors;
- Involving high-level client engagement.

A structured aftercare service includes administrative, operational and strategic support to TNCs. Table 8.5 provides a non-exhaustive overview of services relating to the different categories of aftercare (UNCTAD, 2007, 2008).

- **Administrative services** facilitate the operations of foreign firms. These include obtaining permits and permissions to operate or expand; obtaining work permits for foreign nationals or spouses; help in finding homes for transferred staff or schools for their children; and introductions to providers of services such as banking, legal and accounting services, or property agents/brokers.

Table 8.5. A categorization of investor aftercare services

	Administrative – relate to organizational handlings	Operational – relate to business operations and processes	Strategic – relate to business decision-making processes
Issues	• Administrative follow up; • Permits handling; • Visa handling; • Introductions.	• Land and property (use, expansion issues); • Infrastructure (access, parking, utilities, lighting, electricity); • People issues (staff shortages, skills, recruitment, and training).	• Investment expansion. • Linking investors with local suppliers. • Involve your universities and scientists
	Initial Investment	**Medium term**	**Long term**

Source: UNCTAD (2007)

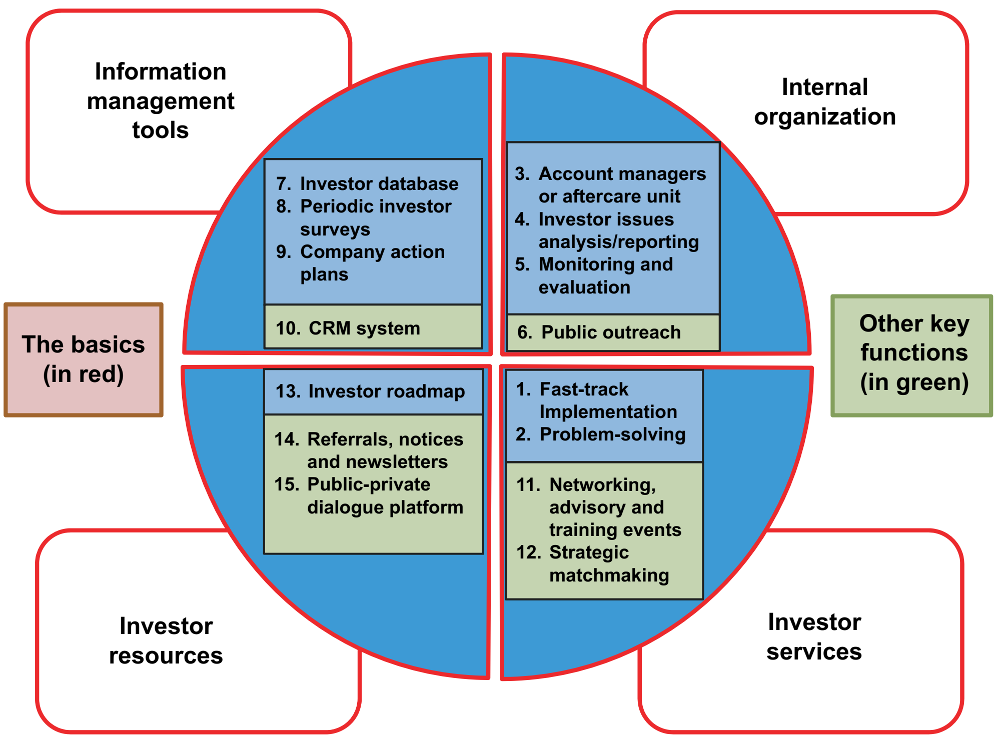
- **Operational services** that support the effective and efficient operations of foreign firms. They include support for training, identifying local suppliers and cluster development to improve productivity and competitiveness, etc.;
- **Strategic services** that influence the future direction of the firm, the development of new capabilities and the corporate development path in the host region. Their aim is to make sure that foreign affiliates stay and continue to expand or upgrade their business activities. They may include support to the development of new, higher value-added products, nurturing local suppliers to international standards, and policy advocacy.

If an IPA does not yet have a fully established aftercare department, then it should begin with providing administrative aftercare services first. Over time, the IPA would be able to develop its capacity to service investor with operational and strategic aftercare services.

Figure 8.4 shows an integrated system for providing aftercare services. It shows the importance of four main components:

- **Information management and monitoring tools** (investor database, surveys,CRM system);
- **Internal organization** (account executives; special unit of the IPA or ISC);
- **Investor resources** (roadmaps, strategic direction and expansion plans of investors; information sources on the investor);
- **Investor services**: (information service, fast-track problem solving, matchmaking, networking.)

Figure 8.4. Elements of a full investor aftercare system



Source: Investment Consulting Associates

There are a number of minimum requirements for effective and sustainable aftercare:

- **Commitment**:
  - taking existing companies seriously;
  - taking start-ups (spin-offs) seriously – they may become BIG.

- **Knowledge and understanding:**
  - an understanding of international investment;
  - sensitive to specific industry and business issues;
  - maintain a structured database.
- **Vision:**
  - a long-term approach;
  - clear objectives – *Account management planning.*
- **Network:**
  - influence and contacts to handle and solve delicate (political) problems;
  - know the ways to deal with bureaucracy;
  - organizational skills to function as an intermediary between both public and private entities.
- **Organizational:**
  - sufficient number and level of dedicated staff to aftercare;
  - ombudsman function;
  - sufficient authority;
  - sufficient resources.

UNCTAD (2007) identifies the following key aspects of setting up an effective aftercare unit which include several steps that are, in reality, taken more or less simultaneously rather than in order:

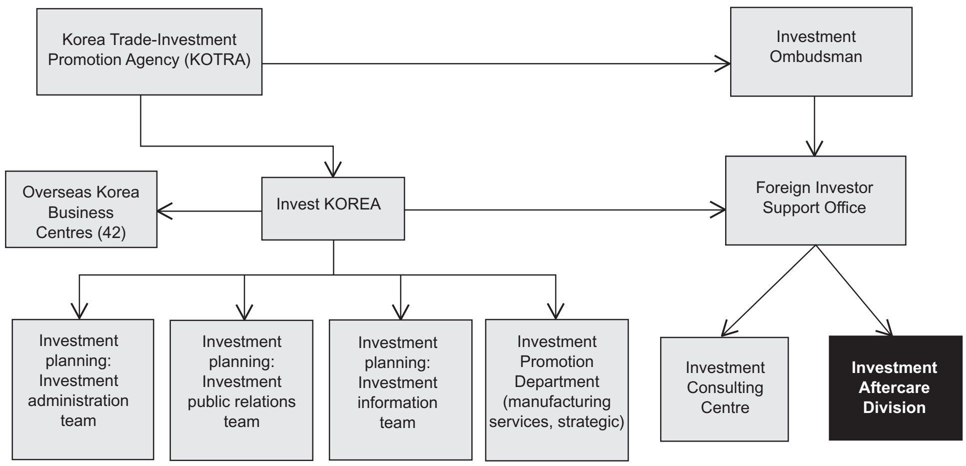
- **Understand the investor community** based on desk research (databases, internet resources) and field research (surveys, company visits). Such an understanding is of course already a prerequisite early on in the investment promotion cycle and investor targeting exercise. However, for aftercare purposes, IPAs need to know about the investor's future expansion plans and strategies (in terms of product and market development, partners, employment, technology, etc.), detailed needs and modus operandi.
- **Develop objectives and identify partners.** IPAs need to identify gaps between investor objectives and economic development objectives of the country/location. Objectives of an aftercare programme can be: (a) increased value-added activities of a targeted set of TNCs; (b) increased employment of certain levels of staff; (c) attraction of suppliers to TNCs, possibly to a specific business park or region; (d) more collaborative projects with universities or other R&D organizations; (e) identification and removal of key barriers to increased reinvestment by TNCs; and (f) increased reinvestment in a specific region. IPAs cannot undertake the aftercare programme by themselves but often need the help of other government and private sector agencies. Therefore, it is important for IPAs to make strong partnerships to enable smooth troubleshooting and problem solving and act quickly on investor concerns, grievances and requests. Some IPAs have set up specific ombudsman services for this purpose (box 8.8).
- **Assess resources and develop organizational options**. Resource availability needs to be matched with objectives. Depending on available resources, the objectives may need to be modified. Resources comprise both financial and in-kind. Partners may provide in-kind support such as staff time and facilities. Following mobilization of resources, the IPA's organizational and strategic options can be identified. For instance, the IPA can choose to provide selected services only on an ad-hoc basis or a wider range of services on a more structured basis. It can choose to delegate certain aftercare functions to partners, use networks for the delivery of aftercare services, or (at the high end) adopt an integrated approach based on a well-structured and well-funded manner (Young and Hood, 1994).
- **Segment, target and design the aftercare programme**. Based on the identified objectives, targets and resources, the IPA needs to segment and design the aftercare programme based on a targeted approach, for instance by investor, by sector or by location. In other words, what type of investment, which investors in which sector and in which location are prioritized and the focus of the programme?
- **Deliver services, monitor and evaluate the results.** The IPA will have to select the modality of delivery of the services. Will everything be handled from the capital or by a local IPA? What kind of staff is required and what training do they need? For each investor, a designated account manager needs to be selected. Account managers can be assigned by the type of FDI, location or by sector if the total number remains manageable. It is understood that not all investors need 24/7 attention and care but in case the overall local investment climate is substandard, the IPA needs to be ready for continuous troubleshooting. Are the services to be delivered by partners or subcontractors? Finally, the IPA needs to assess whether the quality of the services rendered match investor expectations and based on the feedback the programme and/or its delivery may need to undergo changes.

Box 8.8. Best practice in aftercare: Republic of Korea

After the Asian financial crisis in 1997/98, due to the conditionality of the International Monetary Fund (IMF) in exchange for standby credit, the Republic of Korea (ROK) was forced to pursue FDI-friendly policy initiatives. Most notable of these were Invest KOREA and the Office of the Foreign Investment Ombudsman (OFIO), both of which are affiliated with KOTRA, the Korea Trade-Investment Promotion Agency. Invest KOREA is ROK's national investment promotion agency mandated to offer one-stop service to attract FDI, while the Office of the Investment Ombudsman was established to provide investment aftercare services to foreign-invested companies in the ROK (Ahn, 2008).

The Investment Aftercare Team is staffed with experts, also called "home doctors", in the fields such as law, labour, taxation, tariff, customs, construction, environment, finance, foreign exchange, and visa. They conduct activities including identifying and resolving grievances of foreign-invested companies; on-site visits to companies; offering advice on overall business management; proposing system improvements to government ministries and requesting coordination between relevant government organizations in administrative procedures. Figure 8.5 shows the role of aftercare in the institutional framework for investment promotion and facilitation in the ROK.

Figure 8.5. The role of aftercare in the institutional framework for investment in the Republic of Korea



Source: KOTRA, Investment Korea Brochure, April 2016. Available from **http://english.motie.go.kr/wp-content/uploads/2016/09/Invest_Korea_2016_April.pdf.**

The OFIO system has been introduced as an ideal case for FDI promotion and aftercare services at the global level (KOTRA, 2016). UNCTAD has awarded KOTRA the 2006 World Association of Investment Promotion Agencies (WAIPA) trophy for excellence for the establishment of OFIO system (Ahn, 2008). According to KOTRA (2016), reinvestment accounts for the largest component of total FDI in ROK – nearly half of total FDI for the past five years. And OFIO has handled a total of 462 grievances and attracted $1,052 million of the total $8,687 million in FDI in 2015 through grievance resolution activities and communication with foreign-invested companies on a regular basis (table 8.6).

Table 8.6. Selected cases of attracting reinvestment through grievance resolution in the Republic of Korea in 2015

Company Name (Parent Company's Location)	Business Type	Notified Reinvestment (US$)	Grievances
Landing Jeju Development Co., Ltd. (Singapore)	Real Estate Lease	100 million	Support for grievance regarding suspension of certification/approval process for development projects. Support for administrative interpretation regarding separated reporting of commencement of construction.
Siemens (Germany)	Electrical/Electronics	52 million	Grievance regarding insertion of Korean text on outdoor advertisement. Support for new project site.
Living Social Korea (US)	Wholesale/ Retail (Distribution)	64 million	Grievance related to electronic prepayment means under the Electronic Financial Transactions Act.
W-Scope Korea (Japan)	Chemical Engineering	50 million	Grievance related to customs duties exemption or reduction regarding conversion of convertible bonds.

Source: Ahn (2008); KOTRA (2016)

In addition, there are a number of additional important considerations for setting up an effective aftercare programme as shown in table 8.7.

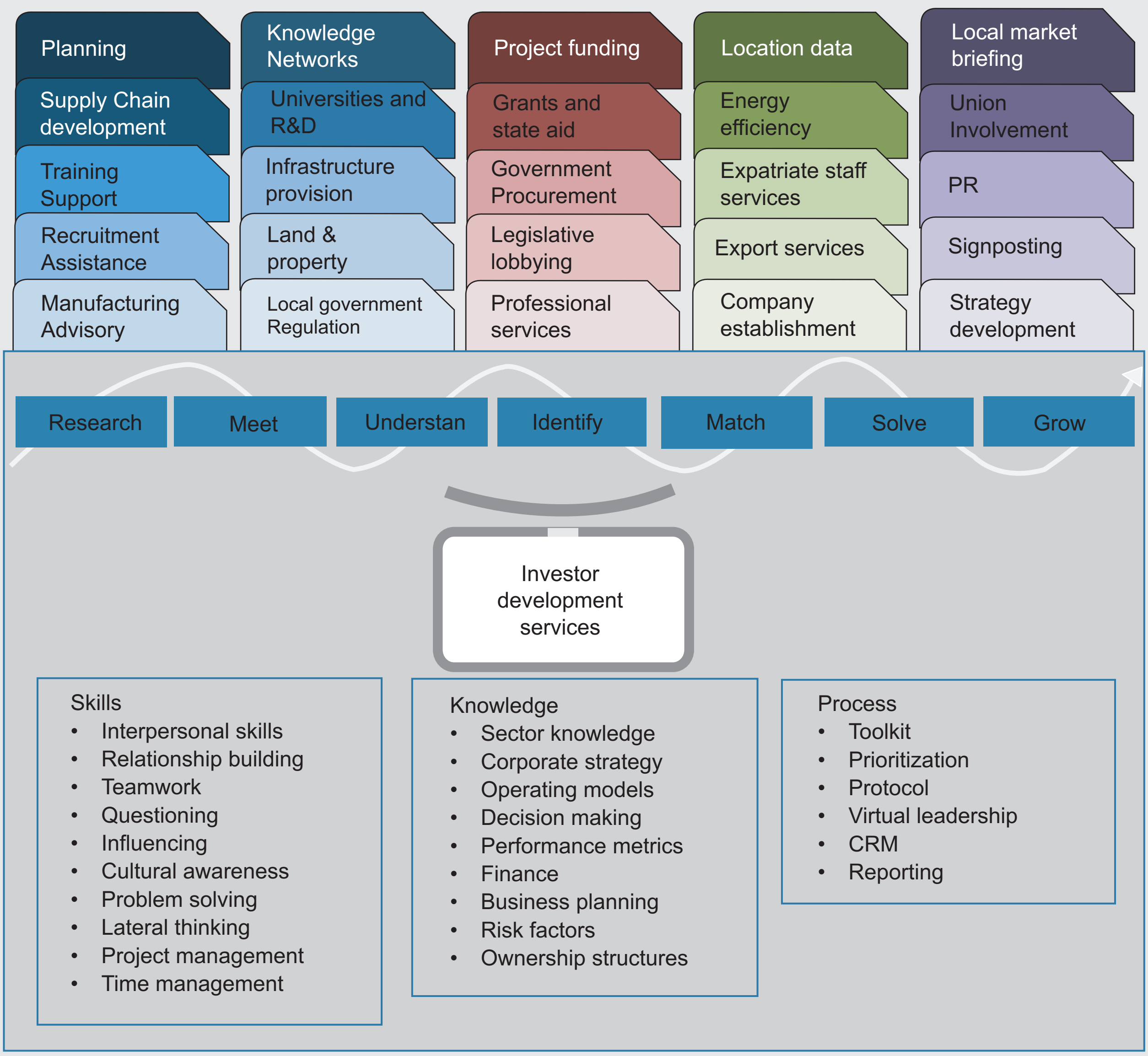
Table 8.7. Important considerations in setting up an effective investor aftercare programme

<table>
<tr><th colspan="2">Objective and long-term buy-in</th></tr>
<tr><td>• Developing existing investors can generate greater economic returns than continually chasing new investment.
• The objective of investor development is to grow the productive capacity of the country.
• This can be achieved by increasing company scale, increasing the value of on-site activity or increasing the level of local activity undertaken by the investor.</td><td>• A company which does not evolve or re-invest is unlikely to remain in place for more than 10 years.
• A strong relationship with an international company is likely to generate multiple project opportunities over a period of time.
• Greater involvement from a well-integrated investor creates a stronger multiplier effect than from a new international investor.
• Investor development will not save every investor but undertaken effectively it will result in both a reduction in disinvestment and also a greater economic legacy from those who eventually depart.</td></tr>
<tr><th colspan="2">Team work</th></tr>
<tr><td>• Effective investor development will fail without the team sharing a common objective.
• That team will probably include members from different organizations but they must all share ideas and accept responsibility.
• The account team will require a leader and a clear plan of action. Over time different team members may involve directly with the target.</td><td>• The identity of the account team leader will be the initial recognized point of contact for the client and will be the person who co-ordinates activity.
• It is important to recognize where decisions are made in the company and how these can be influenced.</td></tr>
<tr><th colspan="2">Targets</th></tr>
<tr><td>• If a project was worth securing as an inward investment, it must be worth supporting as an existing investor.
• In many cases, insignificant potential investors are over-serviced whilst existing important investors get no or too little support.
• Investor development managers should not be the supporter of lost causes.
• Investor development is about proactively selecting priority accounts and not simply reacting to requests.</td><td>• Reacting to crises in companies usually involves offering too little too late and time spent trying to resolve crises wastes an opportunity to help develop an opportunity client.
• The choice of target will reflect the objectives of the organization:
– Fast growing company
– Active in a priority sector
– Embedded most in local economy
– Largest contributor to local welfare
• It is important to maintain a consistent approach and not to take on too many accounts.
• Poor investor development is likely to achieve as little as none at all.</td></tr>
<tr><th colspan="2">Engagement</th></tr>
<tr><td>• It is difficult to gain initial credibility with significant companies but continuous engagement with these companies is instrumental to success.
• Research, effective questioning, and follow through on offered and promised actions can overcome initial resistance.
• Investor development is not about fiercely guarding relationships.</td><td>• If the wider team can open doors, create introductions and offer expertise on projects, the programme will be more effective.
• The final result can be an organization embedded in a region with multiple contacts working on incremental projects.</td></tr>
<tr><th colspan="2">Influence and tools</th></tr>
<tr><td>• Trust and influence are gained over time by understanding the client and meeting their needs.
• Create an account plan and monitor performance – but remember investor development is not just about helping the company – you have objectives too.
• The relationship should also identify those services which will add most value both to the client and the needs of the wider economy.</td><td>• The delivery of investor development services involves a continuous process of research, meet, understand, identify, match, solve and grow (figure 8.6)
• It also requires skills, knowledge, and established processes (figure 8.6.).</td></tr>
</table>

Table 8.7. ***(continued)***

Key account & account management
• Account management is a detailed process, more than 40 accounts per person is probably too many. • More than five years without a significant change in an international company is a long time. • Target a 15% success rates or 4-6 successes per person per annum. • Successful key account management requires influencing through a number of incremental steps. • And it requires balancing investor goals and needs with the goals and needs of the country.

Figure 8.6. Influence and tools for effective aftercare



Source: Investment Consulting Associates.

It is important to note that countries often want to stimulate economic growth away from major urban cities, including the capital, in the provinces and less developed areas. As a result, FDI is often promoted in those areas which are, by definition, less attractive to investors in the absence of a conducive investment climate. The promotion and facilitation of FDI away from the capital is often undertaken by local IPAs, either independently or as local offices of the main capital-based IPA. Quite often, the national capital-based IPA remains in charge of issuing licenses and leaves the facilitation and aftercare aspects to the local IPA which is not always well prepared to undertake such functions. Sometimes, local IPAs need to implement aftercare programmes prepared by the capital and in other cases local IPAs need to design their own as the conditions of one locality may differ from others and investors need tailor-made aftercare programmes. Worse, often local administrations compete for the same investment and issue their own investment regulations which may be different or conflict with national regulations on investment (box 8.9). This is particularly so in countries with federal administrative structures where states or provinces have a significant power to issue state-based laws and regulations. In this case, investors need to navigate several layers of government authorities which require the assistance of both national and state-based IPAs. IPAs may even operate at the municipal level. This means that there should be close coordination between the national IPA and local IPAs at all geographical and administrative levels (Loewendahl, 2001). Such coordination should cover the following (VCC, 2009):

- An agreed list of aftercare companies and decision-making contacts;
- The key account manager for each company;
- Profiling of companies;
- Reporting mechanisms and frequency of meetings;
- Convergence or complementarity of national and local laws, rules and regulations;
- Understanding of how contacts with the parent firm's headquarters are coordinated;
- Processing and addressing investor concerns and grievances (some can be dealt with locally, others require national level action);

Box 8.9. National and local IPA coordination: the case of Viet Nam

From 2000 to 2003, ESCAP implemented a project under a wider programme called Forum for the Comprehensive Development of Indo-China (FCDI) which aimed at helping countries in the GMS, i.e. Cambodia, Lao People's Republic Democratic and Viet Nam, to facilitate the implementation of FDI projects in order to improve their investment realization rate. The core government agency responsible for FDI promotion at that time and still today, was the Ministry of Planning and Investment (MPI). MPI was in charge of implementing FDI related laws and regulations and issued decrees. However, at the provincial and municipal level, individual People's Committees (PC) enjoyed a lot of latitude to promote and facilitate FDI in their respective provinces and virtually each PC had its own Department for Planning and Investment (DPI). While investment approvals took place in Hanoi by MPI, implementation of FDI projects often happened in the provinces far away from the capital, including in Ho Chi Minh City in the South, the Mekong Delta (Can Tho) and Central Viet Nam (e.g. Danang).

In implementing the project, ESCAP aimed to bring national and local government officials in charge of investment together with investors to identify problems and obstacles to smooth the implementation of investment projects. A major obstacle that emerged was effective coordination between MPI and the respective DPI offices in the local PCs. In fact, it appeared that often individual provinces and localities were competing with each other for FDI on the basis of regulations and offering incentives while a national level coordination strategy was lacking.

Today, the individual PCs still enjoy considerable flexibility in dealing with FDI but understanding about investor needs in realizing and operating a project has significantly increased. MPI has also increased its coordinating role through the establishment of the national Foreign Investment Agency under MPI which has set up Investment Promotion Centres (IPCs) in Central, North and South Viet Nam. Of these centres, the IPC for Central Viet Nam (Danang) seems to be the most accessible though the focus seems to be still on investment promotion rather than on investment facilitation **(http://centralinvest.gov.vn/Content/ipcc-structure-of-organization-146.aspx).**

To illustrate the issue further, some provinces and municipalities have their own independent IPAs. For instance, there is a separate Investment Promotion Agency (IPA) Danang which is the main IPA for investment promotion and facilitation for Danang City and reports directly to the Danang People's Committee**. (http://www.ipc.danang.gov.vn/en/web/ipc-english).** The relation and division of labour between IPA Danang and MPI's IPC for Central Viet Nam is not clear and may require further clarification.

Source: ESCAP, Foreign Investment Agency of Viet Nam.

- Other issues requiring division of labour between the national and local IPAs;
- Government-investor dialogue and consultation mechanisms (both at national and local level).

Apart from coordination among national and local IPAs and between IPAs and other involved agencies, there are a number of other challenges to the effective delivery of aftercare services as identified by UNCTAD (2007, 2008) and Young and Hood (1994). These are the following:

- **Institutional credibility**: IPAs need to earn trust and confidence which can be gained at the stage of investment promotion and targeting through company visits and competently executed site visits. Testimonials from other investors also help. When the IPA makes repeated mistakes or shows unprofessionalism, it will face an uphill battle to regain the trust. First impressions matter.
- **Capability of staff**: Because the institutional credibility is so important, staff need to be well trained and competent to perform the duties of an account executive. Often, experience can only be gained only after some time. However, competent staff need not necessarily have an investment background but rather be familiar with customer service. The attitude of staff is as important as their knowledge and experience. When staff cannot answer investor queries immediately but get and deliver the requested information promptly, investors will have a favourable impression of the staff and, by extension, of the IPA.
- **Influencing investors**. Obviously, institutional credibility and staff competence are required for the IPA to influence investor decision-making. However, where the investor remains reluctant to respond to the services or advances of the IPA, it is better to divert resources to investors who are more responsive. If the IPA persists, it may be perceived as a hassle rather than service. IPAs need be pro-active rather than reactive but sometimes it is better to demonstrate the services elsewhere and let the investor decide when to seek assistance, as long as the investor has recourse to a state-of-the-art website and information.
- **Continuity**. The need for a long-term relationship is important to keep investors engaged in the country/locality. Continuity is enhanced through effective customer relationship management systems. A major challenge here is to keep qualified and experienced IPA staff. Staff turnover is a particular challenge in emerging developing countries where career prospects are plenty. IPAs therefore need to offer an attractive package for new staff with clear opportunities for career advancement. Where IPAs cannot provide effective services, such services may be outsourced to other agencies.
- **Customer responsiveness**. Dealing effectively and promptly with investor queries is essential for IPAs to build institutional credibility (see also below). However, sometimes IPAs are not able to respond quickly, in particular as they have to await policy instructions. In other words, IPAs tend to follow policy-driven timeframes and not the investors time frame. In those cases, it is important for IPAs to manage effective investor expectations from the IPA and work continuously to upgrade services. Some IPAs have issued client charters which indicate the amount of time it takes for the delivery of key services.

E. EFFECTIVELY DEALING WITH INVESTOR INQUIRIES

Handling investor inquiries as professionally and effectively as possible is critical to the success of a location in attracting inward investment. According to VCC (2009), in most IPAs up to 50% of leads come from “in-bound” (reactive) inquiries, and this proportion is expected to increase as the web becomes more important.

Investor inquiries are required at various levels throughout the investment promotion cycle. The role of the IPA corresponds accordingly: from general online business information and inquiries in the initial phase of corporate site-selection to site visits, investment (incentives) negotiations and fast-tracking procedures in the long-run. This is a process of follow-up, customer care and developing a relationship with the customer.

Effective investor inquiry-handling is at the core of investment promotion (World Bank, 2012). As part of the Global Investment Promotion Best Practices (GIPB) project, the World Bank (2012) conducted a survey on IPA practices in responding to investor queries (table 8.8). It found that though many IPAs had relatively good websites, their inquiry handling was relatively weak and getting weaker. In particular, it found that 80% of IPAs covered in the survey did not provide any response at all for one or both of the inquiries made by GIPB. Among the top ten best performers was only one IPA from Asia-Pacific: Invest Hong Kong at number six (**http://www.investhk.gov.hk/index.html**). PRONicaragua was number one **(http://pronicaragua.gob.ni/en**)

(box 8.10). The GIPB analysis also showed that countries with IPAs that were more professional in dealing with investor inquiries also attracted higher volumes of FDI (Harding and Javorcik, 2012).

Effectively responding to investor inquiries involves understanding investor needs and location requirements (Loewendahl, 2001). In most cases, IPAs can expect what investors need and pro-actively provide substantive information on their websites, including FAQs. UNCTAD is helping countries to provide information on their investment regulations all through the investment project cycle through a project called eRegulations (box 8.10).

Table 8.8. GIPB categorization of IPAs in terms of dealing with investor inquiries

Category	What it involves
Best practice	IPA provides a well-presented, thorough response. Goes beyond answering the questions to advocate for the location's selection, then diligent follow-up on the project's progress. Maximizes the chance of staying at the top of the investor's list.
Good	IPA answers all questions in good detail and makes a partial business case, but could be more thorough in document development and follow-up. Chances of staying on investor's lists depend on the level of service and diligence of competitors with similar profiles.
Average	IPA provides a reasonable response that attempts to answer all of the investor's questions but lacks depth and has gaps. Does not present a business case. Chances of staying on the list are seriously diminished, with some opportunities probably lost.
Weak	Provides a very limited response, answering few of the investor's questions or merely referring questioner to the website. Given the minimal level of assistance and information on which to base a decision, the location will most likely be dropped from consideration.
Very weak	No response. Performance assessed at below 10% indicates that little or no contact could be made via email or telephone. IPA will not be regarded as a viable business partner, leaving a very poor impression of the location.

Source: World Bank (2012).

Box 8.10. UNCTAD's eRegulations in Viet Nam

UNCTAD has developed an electronic tool called eRegulations to help governments make rules and procedures fully transparent and to facilitate business, trade and investment. The eRegulations system ensures maximum transparency of investment procedures, in order to facilitate national and foreign investment in income- and employment-generating activities. It gives precise online and printed information on how to carry out administrative procedures, such as registering a business, hiring employees, and paying taxes. Each step in each process is outlined, together with the name and contact details of the person who deals with the matter in question. Details are provided about the necessary forms, the processing time, the fees, and the relevant legal requirements.

During implementation of the eRegulations system, such procedures are often clarified, and may be simplified, resulting in faster operations that help to spur investment and business activity as well as the creation of new jobs. It has been installed in various countries and cities worldwide, since 2005.

The eRegulations system is a Content Management System (CMS). It allows, from the administration interface, modifying the public interface (colours, texts, pictures, logos), registering and updating the procedures and the corresponding data, ordering the menus, creating users and granting administration rights, defining the recipient of user's feedback, etc. Information is displayed through a user-friendly, public website. Users can interact with the site and its administrators through email and online chat, for any inquiry, suggestion or complaint.

Procedures are presented step-by-step, from the user's point of view. Every necessary interaction with a civil servant is considered a step. For each step, the system shows the following information:

- Name of the step;
- Result of the step;
- Entity/office/officer in charge, with contact data;
- Requirements (forms and documents);

- Cost;
- Duration (minimum and maximum);
- Entity/office/officer in charge of attending complaints, with contact data;
- Legal justification;
- Authority certifying that the step is correctly described.

For each procedure, the system presents a list of required steps and a summary showing the entities involved, the expected results, the requirements, the minimum and maximum duration and all legal bases.

User countries are granted an unlimited right to use the system and to configure it according to their needs. They decide freely on the procedures they want to register and have full ownership of all information in the database.

One country that has successfully implemented the eRegulations system in its provinces is Viet Nam. The provincial eRegulations systems now operational in Hanoi, Da Nang and Ho Chi Minh City are also accessible via a national portal, allowing for a comparison of procedures among cities. The extension of eRegulations to the provinces of Vin Phuc, Hai Duong, Binh Dinh and Phu Yen will be carried out by UNCTAD experts in collaboration with Viet Nam's Ministry of Planning and Investment. In addition, UNCTAD will assist the existing user provinces in extending the scope of the system to include investment procedures in Viet Nam's "conditional sectors".

More information on UNCTAD's eRegulations system can be obtained from: **http://businessfacilitation.org/eregulations/overview.** For Viet Nam's specific eRegulations system, see: **https://vietnam.eregulations.org**.

Source: UNCTAD.

When IPAs receive an investor's inquiry, the inquiry can be screened in terms of importance. Not all inquiries deserve a similar quality response. Only if the query comes from a targeted investor in a targeted priority sector, IPAs need to respond as soon as possible with a top-quality response and proceed to follow up with the investor. The limited capacity of IPAs prevents them to provide similar responses to all inquiries. Often, the inquiry is not serious. Key questions include;

- Has the individual successfully made investments before (with sufficient evidence)?
- Does the individual have the financial means to make an investment (with evidence)?
- Are there credible references for the individual?
- Does the individual have credible linkages in the region? (VCC, 2009).

Processing inquiries consists of three levels: **general inquiry, sector inquiry and priority sector inquiry**. The first level, general inquiries, requires general pieces of information on the investment climate, procedures and macro level analyses. Such information can be processed by junior officers and/or FAQs and should be immediately provided (in less than 24 hours). The next level refers to sector-related information that is project-related but targeted at non-priority sectors. Following up on such inquiries firstly requires an immediate response (less than 24 hours) and secondly a more thorough response (maximum five days later). Experienced officers using phone calls are a desirable means to answer such inquiries. Follow-up is desirable after some time. The third and most intensive level consists of project-related and strategic priority inquiries and need to be addressed by sector specialists. Again, an interim reply of 24 hours is necessary, followed up by five days of intensive research and preparation of a thorough reply. This process should be followed up two days later.

Apart from this strategy, it is crucial that inquiries are replied to in time. The IPA should better specify the timeframe for a full response in its initial response. During this period, IPA should continue the direct contact with the company to deliver the features, benefits and proofs of the location and even a site visit to the company. Experienced IPAs might prepare a project brief for a serious inquiry.

Best practices in handling an inquiry include (VCC, 2009):

- Understanding an investor's requirements;
- Appointing a single client executive to respond to inquiries;
- Rapidly providing accurate, timely information and data;
- Ensuring the confidentiality of the investor's project and strategy at all times – limiting the number of people involved and even signing a confidentiality Agreement;

- Ensuring an understanding of the project in key ministries and agencies at the national level (for major projects);
- Encouraging diplomatic service visits to corporate headquarters (for major projects).

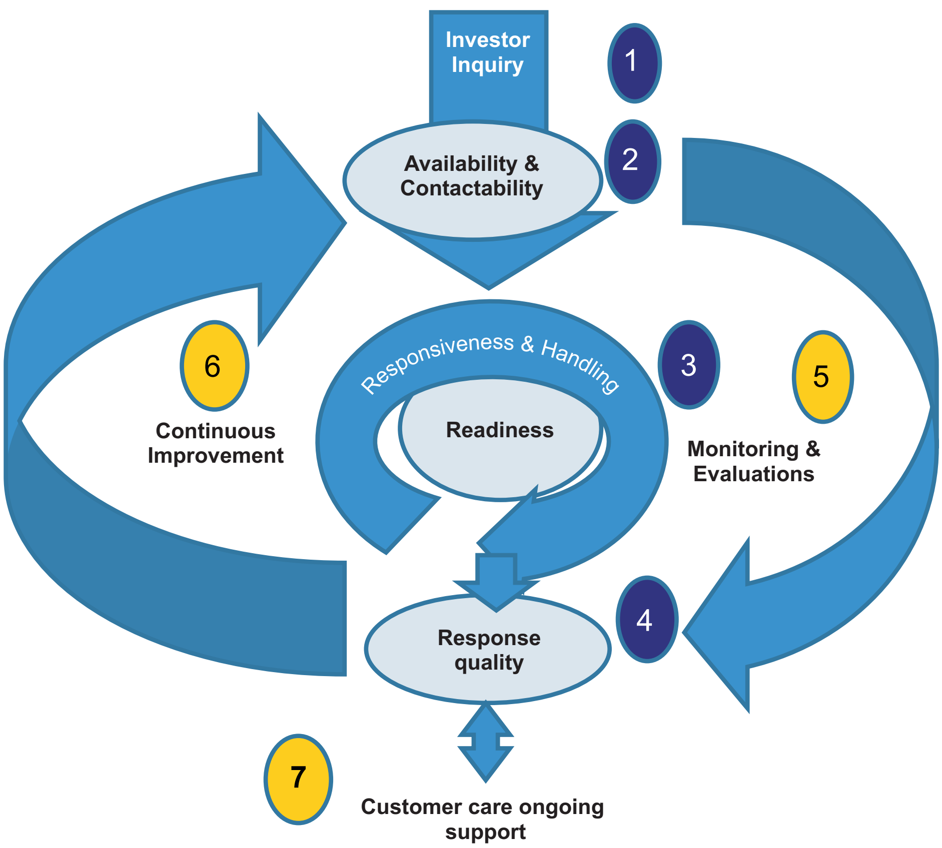
The World Bank (2012) distinguishes four key dimensions of effective inquiry handling: (1) availability and contactability, (2) responsiveness and handling, (3) response quality, and (4) ongoing customer care, in an integrated system that is continuously monitored for improvement (figure 8.7). In its 2012 GIPB mentioned above, the World Bank ranked PRONicaragua as the number one in terms of investor inquiry handling (box 8.11).

(1) Availability and contactability

Companies look first for contacts on the IPA's website. Best-practice IPAs have accurate contact details for officers or for certain types of inquiries (e.g., by sector). IPAs need to be easily contactable. Most investors begin their inquiries via telephone or e-mail. IPAs must be able to respond appropriately to telephone inquiries. Best-practice IPAs ensure that when an investor calls during business hours the telephone is answered promptly. If for some reason the call cannot be immediately answered, the caller should be asked to leave a message. Messages should be returned at the earliest opportunity, certainly within one business day. Good IPAs conform to the norms of good business practice when answering the telephone. They answer by providing the speaker's name and the IPA's name, and by asking how the IPA can help the caller.

Good IPAs also conform to good e-mail etiquette. They acknowledge receipt either by e-mail or by phone and provide an indication of when the investor may expect a fuller response. Best-practice IPAs tend to call the investor to find out more about the project, so that their responses can be specifically tailored to the investor's needs. If the appropriate project officer cannot take the call, the staff member who does take it should ask some basic questions to try to ascertain the nature of the inquiry. In this way, the call can then be forwarded in the most appropriate manner. If the project officer is unavailable, a message should be taken. The message should include the caller's name, the nature of the inquiry, and a good time for the project officer to call back (as provided by the caller). A best-practice IPA never asks the caller to call back later.

Figure 8.7. An integrated system for effective investor inquiry handling



Source: Investment Consulting Associates based on World Bank.

Best-practice IPAs provide accurate contact details of a specific knowledgeable project officer. This officer is usually able to manage the inquiry in its entirety. It is not good practice to forward the investor to multiple contacts within an agency or, even worse, to other agencies or departments in the government. Responding within the investor's specified time frame is highly desirable (the earlier the better), as the company will have internal deadlines.

(2) Responsiveness and handling

Best-practice IPAs have carried out extensive research into their countries'/locations' industries and international trends so that they are prepared to respond intelligently to investors' inquiries and add value by pointing out additional relevant information that the investor may not yet have considered.

Best-practice IPAs have put in place sound internal systems, processes, and training to ensure that when an investor makes contact all IPA staff members have a clear understanding of their own roles in the inquiry-handling process. Best-practice IPAs seek to learn as much as possible about the investment project and the investor's business and have enough experience to engage with investors in an informative and professional manner.

There are techniques to learn to improve responsiveness and handling capabilities:

- Confirm that you have received the investor inquiry;
- Mention a timeframe when a full response will be sent;
- Listen, summarize and understand the inquiry (in case of a call);
- Sector research should be carried out (trends, new developments, etc.);
- Involve subject matter experts if you lack the specific knowledge;
- Update the CRM Database.

(3) The quality of response

It is good practice to answer all the investor's questions and to organize the response in such a way that the investor can readily locate the answers to questions posed. For this reason, it is best to provide the response in a single document or presentation and to include a table of contents. Best-practice IPAs tend to include a summary, either at the beginning or the end of their responses, which highlights exactly why the location is the best one for the investment. Investors often use this summary in their own internal reports; by providing it, the IPA saves the investor time but also ensures that the right arguments are made for its location. It is always desirable to include hard facts from reliable sources and current comparative data. Investors also appreciate case studies of other investors or testimonials from well-known companies, as this quickly establishes that the location is viable.

Best-practice IPAs understand the key investment issues in any given sector and are able to anticipate and respond to questions that an investor may not have yet asked. Being able to provide additional, relevant information helps demonstrate an IPA's awareness and understanding of the company's business environment and needs. Additional information that is not relevant is not desirable. Responses should also include a summary of the services and support that may be available to the investor. Best-practice IPAs use this as an opportunity to demonstrate to the investor that interaction with the IPA is desirable, ensuring ongoing involvement in the project.

(4) Customer care and monitoring

Best-practice IPAs also try to contact the investor within two weeks of responding to the inquiry to ascertain if the IPA can do anything else to support the project. Such follow-up helps ensure the IPA's continued involvement in the project. If the investor chooses to locate the project elsewhere, best-practice IPAs try to learn why. Typically, the project manager contacts the investor to ask for feedback so that appropriate action can be taken in the future.

Box 8.11. Best practice in handling investor inquiries: PRONicaragua

PRONicaragua is the official Nicaraguan IPA. The agency was created in 2002. It is a public-private, non-profit institution, that is ascribed to the Presidency, with the mission to contribute to the country's economic development. It offers the following services to investors:

- General information on regulations, legal framework, business opportunities and key investment information;
- Facilitation services advising companies in their assessment by providing and helping analyse tailor-made information specific to their operations' needs;
- Organization of customized site visits to learn about reality on the ground and meet key both public and private sector contacts;
- Introductions to local companies for possible joint ventures and identification of suppliers and other forms of business alliances;
- Assistance with identifying the ideal real estate options specific to the project's needs;
- Aftercare services to support companies throughout the entire setup process and the operational phase. Also identifying main problems affecting investors to improve the business environment.

Motivated by the results of the 2009 GIPB, PRONicaragua decided to develop a work plan aimed at ensuring a top five positions in the World Bank's next evaluation (2012): The plan consisted of two basic tasks: (1) Partnering with Harvard-affiliated business school INCAE to develop an comprehensive Continuous Development Plan that would allow the agency to improve its investor servicing, enhance its overall efficiency and optimize its resources; (2) Using the parameters and criteria of the GIBP study of investment promotion best practices to implement an internal programme to guarantee the agency complied with world-class guidelines in terms of investor servicing and using the website as a key marketing tool. As part of this process, the agency adopted the following investor inquiry protocol:

1. Acknowledge receipt of inquiry by e-mail within 24 hours;
2. Give a full or near-full response within seven calendar days;
3. Provide any missing or more detailed information within another seven calendar days, or simply follow up to confirm receipt of response and receive additional questions;
4. In another 15 days, try to arrange a conference call to hear project status, answer questions, and propose a country visit;
5. In another 30 days, inquire about project status, offering a conference call or country visit.

As a result of continuous upgrading of services, PRONicaragua was number one in the GIPB survey 2012. Since then, it has continued to upgrade its website and expand its aftercare services (**http://pronicaragua.gob.ni/en**).

Source: Investment Consulting Associates and PRONicaragua.

F. MONITORING AND EVALUATION OF INVESTMENT PROJECTS

Monitoring and evaluation (M&E) needs to be undertaken by an IPA in two general ways. First, the IPA should monitor the status and progress of investors' projects, starting from the application process to its full operations. Second, the IPA needs to monitor its own performance along the investment project cycle to gauge progress and provide feedback on activities/projects, programmes, and on the IPA's overall institutional performance, including performance of individual staff. This second dimension of M&E was covered in chapter 6. In this chapter, the M&E of investment projects as part of investment facilitation is further discussed.

Proper monitoring of investors' projects should not be associated with just regulation and control, although this is what normally comes to mind when one talks about public institutions monitoring the business sector. Certainly, the IPA has a role in ensuring that the investors follow the conditions and procedures for investment, but monitoring can also be transformed into an important investor service. By monitoring the progress and status of an investor's project application, set-up, and operations, the IPA can identify at an early stage any problems that arise to help resolve them before they get worse. This is an essential part of investment facilitation. Also, monitoring enables the IPA officers to anticipate the next steps and likely needs of the investor, which helps develop a pro-active attitude on the part of IPA officers so that they can provide services and assistance before the investor even realizes he or she requires them. This is good client service and will improve the reputation of the IPA and help attract more investment. Some principles for monitoring investment projects are presented here to guide the IPA in structuring an approach to investment project monitoring.

First, monitoring is intended to identify problems at an early stage when it is usually easier to solve them. A monitoring system that fails to detect problems early is ineffective.

Second, the IPA must remember that firms in various stages of the investment cycle have different needs, and capabilities among firms also vary widely, particularly between SMEs and TNCs. Firms will likely require more intensive assistance and monitoring in the approval and registration (pre-establishment and establishment) stages and when starting up, but there is likely to be less need for frequent monitoring after the firm has been operating for a while. Additionally, SMEs often need to be monitored even more closely, because they usually do not have the resources and personnel capabilities to ensure smooth sailing through the bureaucracy. However, the complex nature of many foreign investment projects may also necessitate a lot of assistance, especially if the bureaucracy lacks the technical expertise to make knowledgeable decisions.

Third, an effective monitoring system requires regular contact with foreign investors. If the IPA lacks personnel such as account managers or case officers, its monitoring system is likely to be ineffectual. Of course, budget constraints faced by IPAs may restrict the size of their staff and hamper their efforts to monitor all of the investors' projects. If this is the case, the IPA might have to make a judgment call as to which investors or projects are given the highest priority for monitoring.

Fourth, investor services, including monitoring, should be personalized as much as possible as opposed to being institutionalized. This refers to assigning account executives to interface with specific investors in order to provide continuity and to ensure that the IPA officer is familiar with the project and its status.

Fifth, the IPA must have strong networks with the business sector and establish a sense of trust in the relationship. If this is accomplished, it is much easier for the IPA to get information from investors to facilitate the monitoring process and early problem identification.

Finally, the IPA's staff must have the requisite skills for effective monitoring. They must know what questions to ask, how the investment process works, what the companies' projects are about, and have critical thinking skills.

How does investment project monitoring work in practice?

Essentially it is the same set of activities described in investor facilitation and aftercare services. The account executive officers ought to contact start-up companies on a monthly basis for the first two years (more or less, depending on the project's complexity) to find out the status of the project and any problems encountered to date. Over time the frequency of contact may be reduced to once a quarter, or quarterly contact may be sufficient from the early stages of operations for less complicated investment projects.

Monitoring requires getting information and feedback from the investor company to determine the status of the project and to help the company stay on schedule or resolve problems. The IPA needs to review what has been done to date to ensure that the company has followed all of the necessary requirements in the registration and start-up of the project. If they have overlooked something in the required procedures, the IPA needs to point this out to the company and offer assistance as necessary.

In addition to monitoring compliance with the formal procedures, the IPA should monitor the investor's infrastructure, labour, and other requirements from the beginning of the project. The IPA can produce a standard questionnaire on these items, asking the company to complete and return it. As investors are busy people, the questionnaire should be brief and to the point. The IPA might discover some previously unmentioned needs or obstacles faced by the investor and might be able to offer assistance. If so, it should follow up again within three months to see if these needs have been met or the problems have been successfully resolved.

Collecting data for monitoring can be simplified by using investor tracking software. The key is to acquire the information as soon as possible instead of waiting to collect information later on. Monitoring is not very effective if problems arise and the IPA's response to them is too late. Also, sometimes it is difficult, if not impossible, to acquire the necessary data as time passes, especially if one-time feedback information is not recorded immediately. The officers handling investment project monitoring must maintain good records of each contact with the investor, noting the status of the project, issues that have arisen, and the corrective actions taken.

As IPAs move towards a fourth generation of investment promotion, their contribution to attracting sustainable FDI has assumed increased importance. In other words, the effectiveness and impact of IPAs can be assessed to what extent their activities have contributed to the increase of sustainable FDI in the country and/or

to what extent FDI attracted by IPAs actually do contribute to sustainable development. Obviously, the challenge is to design frameworks of analysis with parameters that define sustainable FDI and sustainable development. A good start is to take the four dimensions of sustainable development into account when formulating IPA goals and activities, i.e. economic development (linkages, technology transfer, training, etc.); environmental sustainability (minimizing the adverse environmental impacts of investments, mobilizing environmental technologies for conservation, etc.); social development (labour and employment standards, community health, education, training, etc.); and good governance (fair and efficient negotiations, contracts, etc.). The VCC-WAIPA survey undertaken in 2010 has demonstrated that most IPAs have not integrated sustainability either partially or fully into their activities, goals and mission statements (VCC-WAIPA, 2010).

In order to track the performance of investment projects, an appropriate tracking database needs to be available for account executives. An excellent example of an effective investment tracking database is "FDI Accounting", software developed by WAVTEQ (box 8.12). The database tracks FDI performance, economic impact and return on investment and has a seamless integration with WAVTEQ's lead generation CRM database and the Financial Times fDi database.

Box 8.12. Tracking investment performance: WAVTEQ's FDI Monitor and Accounting

WAVTEQ was established in 2010 in Hong Kong, China by Dr. Henry Loewendahl as a spin-off from the Financial Times Ltd. to specialize in FDI consulting and product development. Among its products is the fDi greenfield database developed for the Financial Times and "FDI Accounting", an investment project performance tracking and recording database software which allows IPAs to monitor and evaluate the economic impact and organization of a particular investment. The software uses a cloud-based, easy-to-use data entry platform and front-end application and a methodology based on official IMF and OECD definitions and IPA best practices. It provides qualification of project successes to ensure they meet international standards in FDI.

The software has the following features:

1. Monitors and records FDI projects;
2. Contains company details;
3. Contains project details and status;
4. Location and sector information;
5. Investment and employment;
6. Qualification that announced investments will happen
7. Evidence of IPA involvement in securing the investment;
8. Measures economic impact and "quality" of investment;
9. Measures return on investment;
10. Generates automated reports on FDI performance and return on investment.
11. Seamless integration with WAVTEQ's lead generation CRM database and the Financial Times fDi database.

Access to the database and demos are available at **http://www.fdiaccounting.com**.

Source: Available from **http://www.wavteq.com/ias.cfm**; **http://www.fdiaccounting.com.**

G. DISCUSSION ISSUES

1. What is your investment realization rate compared to overall approved investment? Would you consider this normal, below or above average?

2. To what extent is investment facilitation defined and practiced in your national IPA and local IPAs? How important is aftercare as part of the overall role and activities of your IPA?

3. What is the experience of your IPA with site visits? Have they been successful? Have there been failures and what lessons were learnt? How does the IPA go about strategically positioning a particular location as a favoured location for investors?

4. Does your IPA provide one-stop shop services? Are these services effective and efficient? How does your IPA manage coordination with various involved ministries and agencies with regard to obtaining permits and licenses etc.?

5. Does your IPA coordinate effectively with local IPAs in the provinces or municipalities? What issues related to effective coordination can you identify that should be addressed?

6. Does your IPA have a specific investor services centre? If not, should you have one? If yes, how would you rate its performance?

7. How effective is your IPA or ISC in responding to investor inquiries? What could be improved?

8. Does or should your IPA have an ombudsman service or special unit addressing investor grievances?

9. Does your IPA engage in closely monitoring the performance of investment projects? If not, what is the reason? Would you see value in doing more in this area?

10. Does your IPA have a functioning digital CRM and/or investor tracking system?

11. To what extent does the feedback from investors reach policymakers and policymaking? Do you think aftercare services yield valuable lessons for investment policy?

12. After having considered the various issues involved in IPA roles and functions what is your priority in improving your IPA's performance and services? What about the longer term?

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