

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





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

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# Introduction

Foreign direct investment (FDI) has been long recognized as an engine of growth and development, constituting an important source of financing for development. Increasingly, it has become apparent that not only inward but also outward FDI can make a contribution to national development. However, global and regional political economic risks, such as increased trade tensions, the retreat of multilateralism, and health risks as evidenced most recently by the COVID-19 pandemic, have made the investment landscape increasingly uncertain in Asia and the Pacific. Responding to the risks will no doubt require bold, multifaceted and novel approaches to attract, retain and facilitate investment. It also demands that countries in the region take the necessary steps to reform and improve their investment environments to focus on attracting quality FDI that can contribute to achieving the Sustainable Development Goals (SDGs) and the related 2030 Agenda for Sustainable Development.

A recent United Nations Economic and Social Commission for Asian and the Pacific (ESCAP) study highlighted that on its current trajectory, Asia and the Pacific will not achieve any of the 17 SDGs by 2030. It further noted that while progress has been made on some SDGs, for more than half of them it has remained stagnant or gone in the wrong direction. (ESCAP, 2019). The slow progress made on achieving the SDGs in the region, as well as in other regions of the world, prompted the United Nation's Secretary-General Antonio Guterres to issue a global call for a decade of action to reinvigorate efforts to deliver on the SDGs by 2030. Re-aligning investments, both domestic and foreign, as well as developing and implementing the appropriate investment policies and frameworks that harness FDI are critical to accelerating progress on achieving the SDGs. Doing this, however, requires strengthening policymakers' ability to develop evidence-based policies which leverage FDI and maximize the sustainable development benefits it can bring.

This Handbook seeks to take stock of the findings on and experiences with inward and outward 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 more inflows of higher quality FDI with higher development impact across the four dimensions of sustainable development: economic, social, environmental, and governance. Better promotion and facilitation mean 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 FDI worldwide. The Handbook will not present sweeping new insights or new revealing information. There is really no need to reinvent the wheel. Instead, it is intended to be a useful reference tool for policymakers, legislators and investment promotion agencies (IPAs) providing a one-stop-shop of the extensive literature on FDI that has accumulated over many years, and also 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.

This is the second edition of the Handbook. It has been restructured and updated to include emerging areas of interest for both policy makers and IPAs. New topics that the revised edition addresses include *inter alia* leveraging outward FDI for home country sustainable development (chapter 3), sustainable FDI indicators (chapter 5), a revised chapter on national and international investment governance (chapter 5), digital FDI (chapter 5, chapter 9), a new dedicated section on leveraging special economic zones (chapter 6), a revised chapter on investment facilitation and aftercare (chapter 10), and a new chapter on monitoring and evaluation of IPAs (chapter 11). New updated boxes with examples of the issues discussed in each chapter have been added, and this edition has also been updated to refer to the most recent research and evidence on all the topics it covers.

The Handbook is structured into 3 Parts, each of which can be read separately. Part I focuses on FDI fundamentals and provides a thorough understanding of how inward and outward FDI can contribute to development. Part II of the Handbook covers the key policy, legal and institutional requirements for a good investment climate. *This part is specifically geared towards policymakers designing, implementing, and regulating FDI.* Part III of the Handbook address the modalities of investment attraction, promotion and facilitation. *This Part of the Handbook has been written for IPAs, and is therefore much more practical in nature and contains a series of action points and checklists for IPAs to consider in day-to-day work promoting and facilitating investment.*

Each chapter ends with a series of discussion 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. Readers do not need to read each chapter sequentially, instead it can be read in an order which suits the readers needs and interests. Thus, policymakers may want to skip ahead and read Part II first, while IPAs may be more interested in starting with Part III. Students and academics may be interested in starting with Part I and then moving on to the chapters that are most valuable to their work.

The contents of each chapter are described below.

## **Part I: Sustainable FDI Fundamentals**

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

Chapter 2 looks at the trends in inward FDI over the last few decades and impacts on (sustainable) development. A thorough understanding of the potential and actual impacts of FDI provides useful lessons for policies, laws, and regulations.

Chapter 3 takes up the topic of outward FDI and how it can be leveraged for home country sustainable development. The chapter provides a concrete understanding of and evidence for the effects of outward FDI on sustainable development in home countries and analyzes the policies and instruments that can harness OFDI for sustainable development.

## **Part II: The policy, legal, and institutional framework for FDI: how to build an effective investment climate?**

Chapter 4 provides a thorough coverage of the recommended policy frameworks for creating an enabling environment for FDI. It deals with various policy objectives of FDI, including privatization, linkages, technology development and the sustainability aspects of FDI. It discusses the role of FDI in the context of wider economic liberalization and deregulation and the need to strengthen national competitive advantage.

Chapter 5 looks at the required institutional and legal framework for FDI. This chapter is the largest of the Handbook. It breaks down what investment policies are and explores the trend towards a new generation of sustainable investment policies. The chapter then discusses legal frameworks for FDI 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 6 looks at three important and popular modalities of FDI policy: incentives, performance requirements and special economic zones (SEZs). The track record of experiences with these 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. 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 7 addresses a key objective of most FDI policies – forging linkages between the multinational enterprise (MNEs) investors and local suppliers and other firms in the host economy. Such linkages can lead to positive spillover including exchanges and learning opportunities between MNEs and domestic firms. This chapter discusses the types of linkages that can be created and policy options for forging them.

## Part III: Promotion and Facilitation of Sustainable FDI

Chapter 8 moves beyond investment policy towards investment promotion and starts with discussing the institutional requirements for effective investment promotion, i.e., the structure, set-up, and its relation to other related institutions such as trade promotion offices and government ministries and agencies responsible for policymaking.

Chapter 9 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 digital 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 10 discusses the concept of investment facilitation, what it entails and what IPAs need to do to engage in effective investment facilitation and 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 because addressing the needs of existing investors can prove 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.

Chapter 11 identifies the approaches that can be used to monitor and evaluate (M&E) an IPA's activities internally (from an organizational perspective) as well as externally (the results achieved in terms of investor attraction and facilitation). For IPAs, M&E can be applied to incentive schemes, performance requirements, individual staff performance and goals of the IPA, such as the amount of targeted FDI or number of MNCs in target sectors attracted and projects implemented.

This revised version of the Handbook will act as source book for comprehensive training courses on FDI policy, promotion and facilitation that ESCAP offers regularly to its member States 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. Since the COVID-19 pandemic, these courses have also been offered virtually. Countries are encouraged to submit formal request for assistance on FDI to ESCAP to receive and benefit from such trainings.

In conclusion, 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 welcome to ensure that the Handbook can continuously be updated to include the most relevant research and evidence on FDI. 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](mailto:escap-tiid@un.org).

# Part I

# Sustainable FDI Fundamentals



## CHAPTER



# Foreign direct investment fundamentals

## 1. Definitions of foreign direct investment

The concept of foreign direct investment (FDI) 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).

Certain elements of FDI include:

- Cross-border investment;
- The objective of establishing a lasting interest in an enterprise that is resident in an economy other than that of the investor;
- A lasting interest that is defined as having at least 10 per cent of the voting power of the invested enterprise;
  - Subsidiaries are direct investment enterprises, of which 50 per cent or more of the voting power is held by the direct investor;
  - Associates or affiliates are direct investment enterprises, of which 10-50 per cent of the voting power is held by the direct investor; and
  - Branches are direct investment enterprises, of which 100 per cent 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 or a transnational corporation. As soon as a domestic enterprise



### FDI vs. FPI

FPI is much more volatile than FDI. Whereas FDI entails investment in immovable property and assets, FPI is investment in financial securities that 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, and 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 example, it can quickly draw capital away from emerging markets.

engages in FDI in another country it is termed as such. In this Handbook, the term MNE is used.

Various definitions of FDI have been in circulation. One objective of the current round of revisions to the sixth edition of the International Monetary Fund (IMF) *Balance of Payments and International Investment Position Manual* (BPM6) and the fourth edition of the Organisation for Economic Co-operation and Development (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 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 per cent 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:

- (a) Immediate direct investment relationships that arise when a direct investor directly owns equity that entitles it to 10 per cent or more of the voting power in the direct investment enterprise.

Control is determined to exist if the direct investor owns more than 50 per cent 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 per cent of the voting power in the direct investment enterprise;

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

While these definitions are still valid, it is becoming 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 to which host countries of FDI are a party, according to the United Nations Conference on Trade and Development (UNCTAD, 2016). Box 1.2 explains this further.

The definition used 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.



### Blurring ownership of foreign affiliates

Recent years have seen a significant increase in the complexity of multinational enterprise (MNE) 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.

Foreign affiliates are often part of transnational investment chains. The UNCTAD World Investment Report 2016 notes that more than 40 per cent of foreign affiliates worldwide have multiple “passports”, resulting in investor nationality mismatches. 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 MNEs; 60 per cent 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 (box 1.3). About 30 per cent of foreign affiliates are indirectly foreign owned through a domestic entity; more than 10 per cent are owned through an intermediate entity in a third country; and about 1 per cent are ultimately owned by a domestic entity. These “investor nationality mismatch” cases involve almost half of the foreign affiliates in developed economies, and more than a quarter in developing economies.

The issue of determining nationality is also of importance in investment disputes and for MNEs 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 MNE (investor) and the state that 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 the nationality of legal persons.

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

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

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 a substantial portion of the shares.

*Sources:* Astorga, 2006; Alabrese and Casella, 2020; UNCTAD, 2016.

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).

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 to FDI is 10 per cent. For data on the operations of TNCs, it involves chosen ranges of between 10 per cent and 50 per cent. 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



### 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 example, 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.<sup>1</sup> 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 (Xiao Geng, 2004). Another interesting case happened in India where about 10 per cent of FDI inflows over the last decade are attributed to round tripping through Mauritius, a strategy used by Indian companies for tax evasion and, in some cases, money laundering (Aykut and others, 2017). Offshore financial centres, such as British Virgin Islands, Bermuda, and Cayman Islands, play a similar role.<sup>2</sup>

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.

The OECD’s BMD4 recommends that countries compile statistics on inward FDI by the ultimate investing country. Given the often-complex ownership structures of MNEs, 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 the ultimate investing country identifies the amount of round-tripping in an economy by identifying that portion of inward investment which 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 demonstrates, it is not always easy to determine who is the ultimate investing country.

While reducing FDI round-tripping and mitigating its impact has proved to be difficult, countries can try to limit the incentives by eliminating any treatment differentials based on nationality or firms. In fact, the most important policy measure is to improve the business environment for all firms. Nevertheless, countries also need to adapt to the new playing field for FDI and recognize the trade-offs of their national policies on capital flows. National policy measures must be complemented by international actions. At the same time, all indirect FDI flows should be closely monitored, something that is best conducted in coordination with international partners.

*Sources:* Aykut and others, 2017; Borga, 2016. Reprinted with permission from the Columbia Center on Sustainable Investment, Xiao Geng, 2004.

<sup>1</sup> 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.

<sup>2</sup> Recent data and information on round-tripping of FDI in China can be found in Loewendahl and others, 2016.

quantitative impact of differences in the threshold value used is relatively small, owing to the large proportion of FDI that is directed to majority-owned foreign affiliates.

Although, FDI has commonly been used by many organizations, Governments, policymakers and researchers there are still a number of caveats in relation to FDI data (for a broad discussion about the caveats of FDI data see van den Berghe, 2003 at <https://investmentmonitor.ai/global/can-fdi-data-be-trusted> and Sauvart, 2017).

## 2. A typology of foreign direct investment

FDI can be divided 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 Financial Times Ltd. (see <https://www.fdimarkets.com>, which can be accessed for a fee. In contrast, M&A refers to the take-over 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; 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 Eikon.

Brownfield investment can refer to several different types of investment. For example, it can occur when a company or Government purchases or leases an existing facility to begin new production. It 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.

In developing macro-level theories and explanations, based on micro-level assumptions, it is explicitly or implicitly assumed that there is consistency between

macro- and micro-elements. However, the analytical connection between the micro- and macro-economic level has always been hampered by numerous analytical problems (letto-Gillies, 2002). Different conclusions may emerge, depending on the level of data aggregation.

In addition, from the perspective of government organizations, investment promotion agencies (IPAs) and economic development organizations (EDOs) the focus is on firm-level FDI data rather than macro-level, FDI flow data. After all, the mandate of EDOs and IPAs mainly concerns promoting Greenfield FDI that measure the number of FDI projects, capital expenditures and newly-created jobs. This reveals more evidence on the FDI performance and contribution of EDOs and IPAs than do aggregated national statistics on inflows and outflows of FDI (Loewendahl, 2015). The definition, methodology and macro-level data used by international organizations (e.g., IMF, OECD and UNCTAD) are not designed to reflect and account the investment promotion efforts of EDOs and IPAs.

As the official IMF/OECD accounting method is not designed for investment promotion, there is a clear need for an internationally accepted FDI accounting method for EDOs. As one EDO from a developing country put it: “Most EDOs do not know the criteria that should be used for the qualification of FDI successes or for evaluating their role in the success.” Another EDO from a developed country stated that: “If the Government is going to give you US\$10 million you need to show the return on investment.” While there is homogeneity in the common elements in FDI accounting, every EDO does it differently. Most EDOs have developed accounting methods ad-hoc or not at all. Loewendahl (2016) therefore proposed a standardized accounting method for EDOs to attract greenfield FDI.

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 JV, new assets are created with joint ownership while revenue, 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.

Moreover, the role of Sovereign Wealth Funds (SWFs) in FDI may be declining in importance. Especially as a result of the COVID-19 pandemic, many Governments around the world are withdrawing capital from their SWFs, causing them to reorganize their overall FDI strategy. Therefore, SWFs form one of the main sources of global FDI.

## A. FDI versus Non-Equity Modes: New forms of investments (NFIS)

FDI, including M&As, have often been contrasted with non-equity modes of investment (NEM) or new forms of investment (NFI) strategies that are increasingly

adopted by established MNEs from developed markets. These NEMs or NFI have grown over the past few years, but the data are still limited (OECD, 2019 and AIM Annual FDI Report, 2016). Table 1.1 provides a good overview of the differences of the various strategies.

The various NFI strategies are explained below.

**Licensing:** Under a licensing agreement, a company (the licensor) grants rights to intangible property to another company (the licensee) to be used in a specified geographic area for a specified period. In exchange, the licensee ordinarily pays a royalty to the licensor.



Alternative operating models for foreign market expansion

Ownership	Location	
	Home country	Foreign country
Equity arrangements	Exporting	(a) Wholly owned operations – FDI.
		(b) Partially owned with remainder widely held – FDI.
		(c) Joint ventures.
		(d) Equity alliances.
Non-equity arrangements		(a) Licensing.
		(b) Franchising.
		(c) Management contracts.
		(d) Turnkey operations.

Source: Daniels and Radebaugh, 2003.

**Franchising:** Franchising is a specialized form of licensing in which the franchisor not only sells an independent franchisee the use of the intangible property (usually a trademark) essential to the franchisee's business, but also operationally assists the business on a continuing basis, such as through sales promotion and training. In many cases, the franchisor provides supplies.

**Management contracts:** One of the most important assets a company may have at its disposal is management talent, which it can transfer internationally, primarily to its own foreign investment entities. Management contracts are the means by which a company may transfer such talent – by using part of its management personnel to assist a foreign company for a specified period, for a fee.

**Turnkey operations or contract manufacturing:** Turnkey operations are a type of collaborative arrangement in which one company contracts another to build complete, ready-to-operate facilities.

Companies building turnkey operations are frequently industrial equipment manufacturers and construction companies.

**Joint Ventures:** See above.

**Equity Alliances:** An equity alliance is a collaborative arrangement in which at least one of the collaborating companies takes an ownership position (almost always minority) on the other(s). The purpose of the equity ownership is to solidify a collaborating contract, such as supplier-buyer contract, so that it is more difficult to break – particularly if the ownership is large enough to secure a board membership for the investing company.

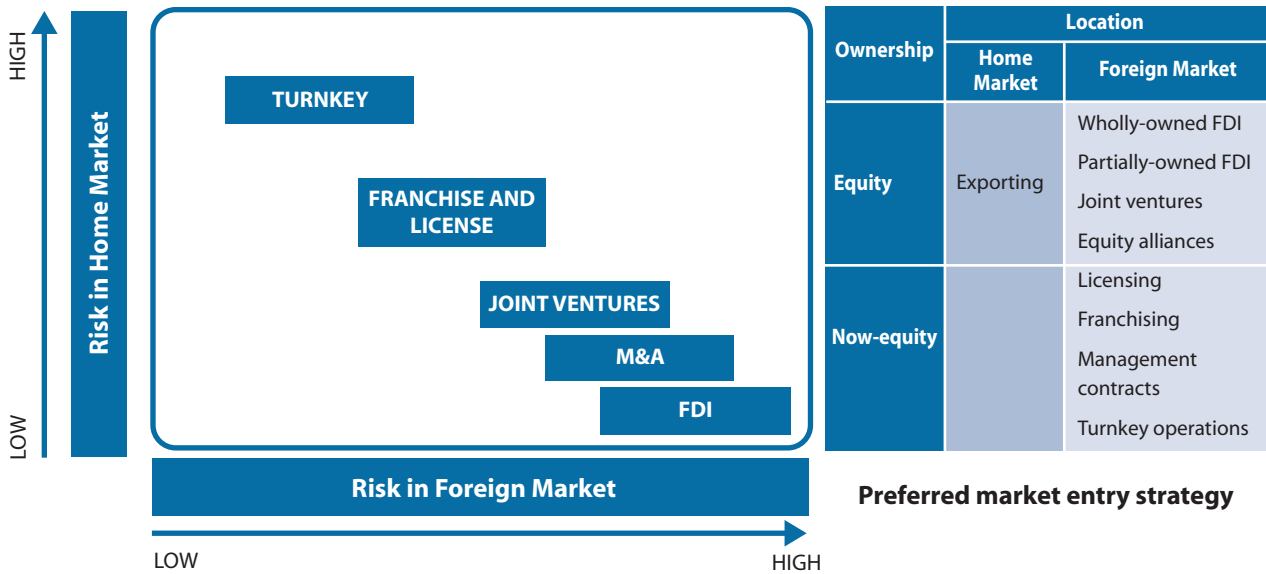
As opposed to other internationalization strategies such as exports, licensing, joint ventures and M&As, greenfield FDI is the most immediate and risky mode of market entry. The investment is directly exposed to the quality of the business environment of the foreign host country, and the company's involvement with

the foreign host country is highest. FDI, as such, is typically vulnerable to current conditions and (unexpected) dynamics in the local business environment, which may directly affect the company’s operations. Therefore, evaluating the host country’s competitiveness according to the particular needs

and requirements of the investor is a critical pre-requisite before realizing an FDI project in order to alleviate and anticipate potential risks. Figure 1.1 illustrates the risk perception of different forms of internationalization by companies.



**Risk perception of various forms of company internationalization**



Source: Investment Consulting Associates.

## B. Motives for FDI

More commonly, FDI is categorized by the purpose of the investment. There are many theories and explanations of why MNEs engage in FDI or international production. Van Den Berghe (2003) distinguished three schools of thought:

1. International business (IB) perspective;
2. International (strategic) management (IM) perspective;
3. International political economy (IPE) perspective.

Research in the field of international business often focuses on the question of why firms become international and why international production takes place. International management research, in contrast, largely addresses the issue of how MNEs organize their multinational activities – managerial coordination, for instance, as part of international human resource management – and relate that to the competitive advantage of multi-nationality. Both alternate strands on internationalization look at the internationalization of firms primarily in the micro

context – IM more than IB – without evaluating the broader (inter)national societal repercussions of internationalization or FDI on economic development as such. On the other hand, the IPE perspective offers tools to conceptualize the relationship between the MNEs, Governments and society, but – similarly to macro-economists – tends to downplay the role of non-state actors and rarely integrate the specific strategies of MNEs in their (policy) models.

However, in contrast to macro-economists, the assumptions of IPE economists often lack solid empirical underpinnings. Macro-economists and IPE economists tend to neglect the role of the firm in internationalization processes. Taken together, the three perspectives on internationalization provide an eclectic view of the determinants and motives of internationalization, the way MNEs organize their multinational activities and the advantages associated with multi-nationality. This eclectic view is more instrumental in explaining and understanding the trends behind internationalization of MNEs. However, the boundaries of the three perspectives are not always clear, nor are they exhaustive.

Besides, the three perspectives are often developed in relative isolation – a ‘victim of the specialization disease’ that has also struck this relatively new area of scientific interest. The following section draws heavily upon the three schools of thought as outlined by van den Berghe (2003).

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):

- (a) (Natural) resource-seeking (supply-oriented);
- (b) Market-seeking (import or export substituting);
- (c) Efficiency-seeking (rationalized investment); and
- (d) Strategic asset-seeking (supply-oriented).

(Natural) resource-seeking MNEs often invest abroad in order to acquire specific resources at a lower cost than in the MNE’s home market (if available at all). Resource-seeking MNEs are often primary producers who want to secure physical supply sources. Most of the FDI during the first wave and second wave of internationalization was motivated by United States and European MNEs securing physical resources of minerals and primary products. Up to the Second World War, three-fifths of the accumulated foreign direct capital stake was of this type, while by the mid-1980s resource-seeking FDI had declined to about one-third of worldwide MNE activity (Dunning, 1993).

The bulk of FDI is still market-oriented, supplying goods or services in the investing market or (adjacent) third markets. In most cases, these markets were previously served through exports from the domestic market (Dunning, 1993). There are four different reasons for market-seeking FDI. First, firms may have to follow their main suppliers or customers that have set up businesses overseas. Second, MNEs may favour a strategy of “thinking global and acting local”, implying that products have to be adapted to local tastes. Third, it may be cheaper to serve a foreign market or adjacent market locally than supplying it from a distance. This reason is especially country- and industry-specific. Some third markets cannot be served through exports from the domestic market, due to local content requirements, tariff barriers or import-substituting trade regimes. Not investing in the foreign market would harm the competitive position of the firm. The fourth and increasingly important reason for market-led FDI is “that an MNE may consider it necessary, as part of its global production and marketing strategy, to have a

physical presence in the leading markets served by its competitors” (Dunning, 1993). This type of strategic market-seeking FDI is largely motivated by a defensive or aggressive strategic rationale.

The key motivation of efficiency-seeking investments is to rationalize the structure of established resource-based or market-seeking investments (Dunning, 1993). Efficiency-seeking FDI takes place among MNEs seeking plentiful supplies of cheap and well-motivated unskilled or semi-skilled labour (manufacturing and service MNEs from countries with high wage costs). This type of FDI is often located in more advanced industrializing countries, emerging markets, such as Mexico and Taiwan Province of China (often in the form of export processing zones or EPZs). More recently, efficiency-seeking FDI largely has taken place among experienced and large MNEs. In order for efficiency-seeking FDI to take place, markets must be well-developed and open. This is why efficiency-seeking FDI flourishes in regionally integrated markets.

There are two types of efficiency-seeking FDI. The first is designed to take advantage of differences in the availability and cost of traditional factor endowments in different countries and locations, explaining the intra-firm division of labour (see the NIDL thesis, section 2.3.2). The second type of efficiency seeking FDI takes place in countries with similar location conditions and income levels. Traditional factor endowments play a less important role, while ‘created’ competencies and capabilities, the availability and quality of supporting industries, the characteristics of the local competition, the nature of consumer demand, and the macro- and micro-policies of Governments play a more important role (Dunning, 1993: 60).

The fourth motive, strategic asset-seeking FDI, is related to FDI aimed at acquiring assets of foreign firms to promote their long-term strategic objectives by sustaining and advancing the international competitiveness of those firms. It is driven by the need of firms to acquire specific technological capabilities as well as management or marketing expertise. The latest angle in the Ownership, Location and Internalization (OLI) paradigm (see section E) for explaining internationalization are linked to the phenomenon of “created assets” (cf. Dunning, 1997; UNCTAD, 1998), which also implies that high-skilled work is a reason for firms to internationalize. This type of strategic asset FDI makes use of local competence levels that are very often created by local or national governments. “The motive for strategic asset seeking investment is less to exploit specific cost or marketing advantages over their competitors (although these may sometimes be



important) than to add to the acquiring firm's existing portfolio of assets, other assets that they perceive will either sustain or strengthen their own overall competitive position or weaken that of their competitors" (Dunning, 1993).

These four types of motivations for FDI have been the basis for explaining FDI by many international business scholars, and are often primarily related to the interaction between the host country environment and the MNE (UNCTAD, 1998). The traditional view in international business approaches is that MNEs are attracted by raw materials and cheap labour in specific countries or regions. According to Kogut (1997), an emerging argument is that country advantages may also be understood as generating trajectories that pull foreign direct investment. In most IB research, characteristics of the host countries provide the most important explanatory variable causing the internationalization process.

Mainstream international business and international management literature often relates causes of internationalization to host country conditions that aim to attract MNEs, or to the strategies of competitors (sections 4.2 and 4.3). Both therefore focus almost exclusively on "pull factors" of internationalization. The home country of the MNE is primarily addressed as the origin of specific competitive advantages. According to many IB studies, one of the main motives for firms to internationalize is to exploit the latter competitive advantage in a host country or region (Knickerbocker, 1973; Graham, 1974; Hymer, 1976).<sup>3</sup> International political economists often argue that other causes of internationalization can be related to the home country. The home country factor for processes of internationalization is important in terms of the size of the home country market. Small economies trigger internationalization at an early stage of a firm's development process (UNCTAD, 1998). According to Dunning (1993), push factors of internationalization play a role when national policies create a stringent business environment. The firm will try to avoid a particular regulatory regime in the home country, leading to "escape investments." In particular, when regulation is strict or uncertain, firms have further incentives to try to "escape" from this particular business environment (cf. Cameron, 1978; Dunning, 1993; Ruigrok and Van Tulder, 1995).

In addition, MNEs may want to nurture the threat to expand abroad or relocate (part of) their production

abroad as a way to influence domestic labour market regulation – without even having the real intention to go abroad. This may result in a "bargaining pendulum" in which MNEs and home Governments are in a continuous process of political bargaining aimed at improving their competitive position (cf. Ruigrok and van Tulder, 1995; Dicken, 1998). Gomes-Casseres (1990) summarized this difference as the tension between what the firm 'wants' and what the firm 'can get'. What the firm can get is largely determined by the bargaining position of the firm and by the framework within which the MNE negotiates with host and home Governments. The threat to relocate may thus function as a political bargaining instrument.

Finally, as already emphasized by Kogut (1989), the nature of the MNE – through its wide network of worldwide operations – creates the possibility of global scanning (Ietto-Gillies, 1992) for efficient low-cost production sites, creating the opportunity to spread risks connected with the social, political and economic environment of countries. In addition, through the global dispersion of international production, as opposed to consolidation of production in a single country within the region, companies can enhance their bargaining power relative to other actors within and beyond the value chain (Ruigrok and Van Tulder, 1995). Hence, the spread of an MNE's activities increases its bargaining power vis-à-vis Governments and labour in particular. The MNE is able to diversify its production over an entire network using 'co-production arrangements' – making the same product in different plants in different countries simultaneously (Glickman and Woodward, 1989).

A production disruption due, for example, to a strike in one location, may be avoided by stepping up production in another location. In addition, later exponents of the market power theory (Cowling and Sugden, 1987) assert that by creating and controlling a network of dependent subcontractors, MNEs are able to weaken trade unions' bargaining position (Ruigrok and van Tulder, 1995; Sugden, 1991), a strategy denoted as 'divide and rule' (Sugden, in Pitelis and Sugden, 1991; Cowling and Sugden, 1987). The literature on international business society management has further explored this area from the perspective of managers in firms. This has become known as "international stakeholder management" (Wartick and Wood, 1999). Pressure on firms to adopt codes of conduct and other forms of sustainable

<sup>3</sup> Whether the country of origin continues to play a significant role even when MNEs have reached a certain level of internationalization (or is instead only confined to the early stages of a firm's internationalization process) is still an issue of considerable academic debate (cf. Hu, 1992; Ruigrok and Van Tulder, 1995; Doremus and others, 1998). Many of these authors argue that the patterns and mode of internationalization continue to be shaped by the specific national context in which MNEs originally operated.

management has mounted due to action of stakeholders such as consumer organizations, other single-issue interest groups (e.g., NGOs) and trade unions. The issues often relate to the position of the firm in developing countries, where the stakeholders generally organize themselves in the homeland of the firm or in any of the other developed countries (cf. Van Tulder and Kolk, 2001).

The literature on the motives for emerging FDI (FDI from developing countries to developed countries) is still limited. However, it challenges the explanatory power of conventional FDI theories (Hymer, 1976; Buckley and Casson, 1976; Rugman, 1980; Dunning, 1988) that depart from the assumption that ownership advantages are a prerequisite for international expansion in the emergence of FDI from developing countries to, in particular, the United States and Europe. Moon and Roehl (2001) therefore qualified FDI from developing countries in developed countries as unconventional FDI, thereby emphasizing that a new framework of analyses is needed to explain this form of internationalization. This direction of FDI is characterized by the search of developing countries' MNEs for complementary assets or technology and management know-how (Moon and Roehl, 2001). This form of FDI is therefore more associated with "strategic or created asset-seeking" (e.g., human capital) motives, than with traditional "asset exploiting" (e.g., low wages) motives. Finally, investments by firms from developing countries in other developing countries is largely in the form of market-seeking investments.

A number of Scandinavian scholars have developed dynamic process approaches towards internationalization. "Among Nordic scholars the question of why FDI is often replaced by the issue of how investments abroad are actually carried out by the firm." (Bjorkman and Forsgren, 1997). Renowned is the Uppsala Internationalization Process model, based on a behavioural theory of the firm (Cyert and March, 1963), by Johanson and Vahlne (1975).<sup>4</sup> It

asserts that the internationalization process is characterized by a gradual, sequential development, departing from the initial export decision of a firm to an increased commitment in foreign markets. The 'psychic distance' (language, culture and education) is overcome by learning experiences in foreign markets (Johanson and Vahlne, 1975 and 1977). According to Johanson and Vahlne (1975 and 1977), the model is based on empirical observations from four studies in international business at the University of Uppsala that show that Swedish firms often develop their international operations in small steps, rather than by making large foreign production investments at single points in time. Typically, firms start exporting to a country via an agent, and later establish a sales subsidiary, and eventually in some cases begin production in the host country.

The Uppsala model offers considerable explanatory power in the analysis of 'beginners' in the internationalization process, but the model is less applicable to established MNEs (Forsgren, 1989). Conversely, one may argue that, with the exception of the PLC model of Vernon (see section 4.2.6), traditional FDI theories (sections 4.2.1 to 4.2.5) are less appropriate for the analysis of 'beginners' in the internationalization process. Acknowledging this criticism, Johanson and Vahlne (1990) stated that "the model predominantly applies to small and medium-sized enterprises (SMEs). When firms have large resources the consequences of commitments are small. Thus, big firms or firms with surplus resources can be expected to make larger internationalization steps." Moreover, the Uppsala internationalization model has been criticized for being too deterministic (Turnbul, 1987) and based on a limited number of case studies in a specific national context, i.e., the initial research into the international expansion of four Swedish companies (Johanson and Wiedersheim-Paul, 1975). In addition to the above theoretical discussion about different forms of FDI, a more practical approach to differentiate between two forms of FDI is between horizontal and vertical FDI as is explained in box 1.4.

<sup>4</sup> Similar process models of internationalization within the Nordic School of Thought, departing from identical assumptions, are offered by Welch and Luostarinen (1988) and Johanson and Mattsson (1988).



### 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 a 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 using 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 car model 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 also 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 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.<sup>5</sup>

Source: ESCAP.

## C. Rationale for foreign direct investment

Many theories have been proposed that explain 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 transferring 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. 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 it 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 (1977, 1980 and 1988), links firm-specific advantages, internalization theory and location theory. Dunning's paradigm is basically an integration of various theories to explain why FDI exists at all. This eclectic theory attempts to explain internationalization motives stemming from advantages that result from the interaction of three interdependent elements, i.e., ownership, location and international environment. In fact, it is the integration of location-specific characteristics that 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 the following three conditions are met:

- (1) The firm possesses ownership (i.e., firm-specific) advantages in comparison to local firms;
- (2) It is beneficial to internalize these ownership advantages within the firm or firm network rather than use the market to pass them on to foreign firms by selling and leasing them to other companies; and

<sup>5</sup> See, for example, Nunnenkamp, 2002, and Tekin-Koru, 2004, on the diminishing role of tariff jumping as a determinant of FDI.

- (3) Location advantages exist that 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., ownership, location and internalize) which combined form the OLI-model. These different elements overlap and interact. This interaction determines which market entry strategy firms choose to internationalize.

- Ownership 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;
- Location 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
- Internalize 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 1.2 illustrates how these three advantages determine the modality of market entry. Modalities are licensing, exports and FDI (as per the more detailed discussion about the different modalities given above). 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 1.2** 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, (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 a firm's behaviour determinants has also frequently been mentioned as a comment.<sup>6</sup> In response, Dunning 1997 extended his paradigm in the 1990s by including "management strategy" as a clear variable, as well as "alliance capitalism"<sup>7</sup> and the increased role of technology. In any case, the rationale and determinants of FDI are increasingly complex, and differ by type and form of FDI. Research in this area is still a work in progress. For emerging economies the Investment Development Path (IDP) theories remain important groundwork for relating the role of FDI to a country's level of economic development (for the original work, see Dunning, 1958 and more recent work on relating outward FDI to economic development by Djokoto, 2021).

## D. Determinants of FDI

### 1. General overview

This section builds on the previous section by examining in more detail the determinants of (mostly greenfield) FDI, particularly those related to the location of an investment. Three categories of determinants can be distinguished, which mostly apply to greenfield FDI (table 1.3). 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).

The specific determinants depend on each type of FDI and the sector in which FDI takes place (box 1.5). For example, resource-seeking FDI is mostly interested in the availability of natural resources in a given host country as well as 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

<sup>6</sup> For a review of the criticism and putting the OLI model in context, see for example, Franco and others, 2008.

<sup>7</sup> Alliance capitalism refers to a system of networks of inter-company collaboration mechanisms or inter-corporate alliances that are formed with the purpose of maximizing profits and gaining access to markets such as the Japanese Keiretsu. Such collaboration may lead to collusion and anti-competitive practices, but is becoming increasingly common in a globalized world, including through mergers and acquisitions.

**Determinants of inward FDI**

<b>1. Economic conditions</b>	<ul style="list-style-type: none"> <li>● <b>Markets</b> Size and income levels; level of urbanization; stability and growth prospects; access to regional markets, e.g., the ASEAN Free Trade Area (AFTA); and distribution and demand patterns.</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>Resources</b> Natural resources; technology and skills resources; labour resources.</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>Competitiveness</b> Availability of an 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 research and development (R&amp;D); financial institutions.</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>Macroeconomic fundamentals</b> Tax rates and structure, inflation rate, exchange rates, interest rates, external debt etc.</li> </ul>
<b>2. Host country policies and legal framework</b>	<ul style="list-style-type: none"> <li>● <b>Macroeconomic policies and laws</b> Fiscal and monetary policy; ease of remittance and repatriation; access to foreign exchange.</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>Private sector policies and laws</b> Promotion and degree of private ownership; clear and stable policies; easy entry/exit policies; efficient financial markets; government procurement; other support.</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>Trade and industry policies and laws</b> Import and export controls/liberalization policies; membership in regional trade and integration agreements; competition policy; support for SMEs; intellectual property rights (IPR) protection.</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>FDI policies</b> 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.</li> </ul>
<b>3. MNE strategies</b>	<ul style="list-style-type: none"> <li>● <b>Risk perception</b> Perception of country risk, based on political factors and macro-economic management, labour markets, policy stability, IPR protection.</li> </ul>
	<ul style="list-style-type: none"> <li>● <b>Location, sourcing, integration, transfer</b> Company strategies on location; sourcing of products/inputs; integration of affiliates and supply chain management; and strategic alliances.</li> </ul>

Source: Based on Lall, 1997.

labour, IPR protection and sophisticated R&D in higher end technology-intensive FDI. Strategic-asset FDI looks mostly for companies in host countries that fit in the MNE 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 at the regulatory environment for the particular services sector (e.g., telecommunications, banking).



### Location factors for FDI

According to an UNCTAD (2016) survey, MNE executives do not commonly agree on the impact of potential factors on future FDI activity. In some cases, it is a matter of perceptions and in others, categories are just complex. Nevertheless, executives strongly considered factors such as the state of the United States economy, trade agreements, ongoing technological change including the digital economy, global urbanization and offshore outsourcing as being likely to boost FDI. Obviously, MNEs have their eyes on longer-term trends, such as rising urbanization in developing and developed countries (and thus, for example, potential consumer markets), the digital economy and the formation of prospective mega-groupings. The importance of these location factors, however, differs between industries, functional activities, entry modes, etc. (OECD, 2011). For example, table 1.4 indicates the criteria by sector.



### Leading factors influencing the location of companies, 2009-2011

(Percentage 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

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; Nielsen and others, 2017).

Source: UNCTAD, 2016.

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

For all types of FDI, the allowed ownership and ease of entry matters as do 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., Hong Kong, China, Singapore, Thailand);
- Access to markets and trade facilitation (cross-border zones and areas, e.g., the 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).

The motives for FDI in general have not changed much over time. However, with market-seeking FDI often being the main driver for FDI, and efficiency-seeking being the smallest proportion to explain FDI, there are changes that take place over time as demonstrated in table 1.5.



**Overview of key motives perceived as critical by FDI investors**

(Per cent)

	2015-2019	2020	Change
Proximity to market or customers	40.0	39.8	-0.2
Domestic market growth potential	37.4	35.5	-1.9
Skilled workforce availability	23.9	26.2	+2.3
Regulations or business climate	21.5	18.2	-3.3
Infrastructure and logistics	11.2	10.5	-0.7
Technology or innovation	10.1	10.8	+0.7
Industry cluster and critical mass	9.5	12.8	+3.3
Attractiveness and quality of life	5.3	3.5	-1.8
IPA, EDO or other government support	5.3	9.4	+4.1
Universities or researchers	4.6	5.0	+0.4

Source: fDi Markets, fDi Intelligence from Financial Times Ltd. Date range, 2015-2020.

Although market-seeking motives for FDI are still the main drivers this has become less important in contrast to prevailing regulations, access to skilled workforce, and the availability of universities and researchers. During the past two years this trend has even become more apparent.

## E. Sustainable foreign direct investment

In recent years, particularly in connection with the formulation and achievement of the Sustainable Development Goals (SDGs) as part of the 2030 Agenda for Sustainable Development (figure 1.2), increased attention has been paid to the concepts of “sustainable” FDI and “social” FDI or more recently “impact FDI” (WAIPA).

Investment in the form of FDI plays a crucial role in making progress towards achieving the Sustainable Development Goals (SDGs). This is due to the various positive impacts that FDI has on job creation, skill development, increased innovation and improving the living standards in the host country. The concept of sustainable development is generally attributed to the Brundtland Report of the World Commission on Environment and Developments published in 1987 which tied traditional economic objectives of countries and regions to environmental concerns by acknowledging the needs of future generations (Dadkhah, 2021). The international discussion that followed has further expanded towards the social and governance issues as similarly essential components of sustainable development.

Figure 1.2 displays the SDGs agreed upon at the United Nations General Assembly in September 2015. These specific and measurable goals are set under a wide range of environmental, social and economic-related issues such as: climate change; energy; water stewardship; conservation of marine life and biodiversity; poverty; food security; sustainable production and consumption; gender equality; and economic growth. While the development of national strategies to pursue the set of SDGs is considered crucial, the United Nations also acknowledged the importance of the private sector in addressing these goals. The SDGs are part of the United Nations 2030 Agenda for Sustainable Development designed to shift the world onto a sustainable and resilient path (United Nations, 2015). Next to the 17 SDGs presented in figure 1.2, 169 additional associated targets have been set which demonstrate further the scale and ambition of the United Nations towards the 2030 Agenda for Sustainable Development.

Sustainable FDI is a relatively new term that is meaningful when considered in affiliation with the efforts towards achieving sustainable development and more specific SDGs. The conditions for FDI to aid sustainable development are such that FDI projects must be commercially viable themselves while also promoting the host country’s development on economic, environmental, social and governance measures (Dadkhah, 2021). Accordingly, the 2015 Addis Ababa Actions Agenda has put forward the crucial aspect of the role of the private sector towards sustainable development; this lies in the adoption of principles for responsible business and



The 17 Sustainable Development Goals



investment, and engagement as partners in the developments process of host countries and regions (UNGA, 2015).

Moreover, the private sector is called upon to invest in areas that are considered critical to sustainable development as well as to aid economies in shifting towards more sustainable consumption and production patterns. Correspondingly, the 2015 Addis Ababa Actions Agenda commits Governments and respective host country agencies to strengthening regulatory frameworks and developing policies that are aligned with sustainable development goals and private sector incentives. The objective is to incentivise the adaptation of sustainable practises and foster long-term investments in the private sector (UNGA, 2015).

Sauvant and Mann (2017), and Kline (2012) categorized the following four pillars or dimensions of SDGs with associated policy areas and their complementary indicators:

(a) Economic: Employment, local linkages, community development, and equitable distribution of wealth, capital, taxes, local

business linkage, technology transfer, infrastructure and exports;

- (b) Environmental: Resource management, pollution controls, waste reduction, biodiversity protection, water, and renewable energy, low carbon footprint, water usage;
- (c) Social: Balanced development, skills enhancement, public health, fair wages, benefits and labour rights, indigenous rights and non-discrimination, gender, and cultural heritage protection; and
- (d) Governance: Anti-corruption and external transparency, risk-management systems, and environmental/social assessment, local management, supply chain standards, marketing practices and stakeholder dialogue. This may also include fair and efficient negotiations, contracts, adherence to international standards of responsible business conduct etc.

These dimensions will complement each other as the point of departure for a possible framework for the attainment and measurement of sustainable FDI impact on an economy (chapter 7).



With reference to the above dimensions of sustainability, sustainable FDI can be defined as FDI that contributes to sustained economic growth, is socially inclusive and environmentally sustainable, or FDI that follows responsible business conduct and contributes to sustainable development (OECD, 2019).

However, while most of these definitions cover, for example, FDI in renewable energy projects such as solar or wind energy (per definition, sustainable FDI), they do not capture the entire picture with regard to issues surrounding the sustainability of a company's operation which are often neglected by policymakers.

A distinction should be made between sustainable FDI and FDI for sustainable development and differentiate three categories of sustainable FDI:

- (a) Sustainable investments (projects) such as investment in solar energy, renewables, waste management etc., and green investments in general;
- (b) Investments that take place in a sustainable way or emphasis sustainability, i.e., investments that lead to spillover effects, create sustainable jobs etc.; and
- (c) Investments that help countries achieve the SDGs.

In addition, socially responsible investment can be defined as investment that factors in environmental, social and (corporate) governance (ESG) in decision-making (negative screening) by 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 of channelling 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 MNE, i.e., the foreign investor. International voluntary standards, guidelines and principles exist to promote such conduct, i.e., the United Nations Global Compact, United Nations Guiding Principles on Business and Human Rights, ISO 26000, Global Reporting Initiative and sectoral standards. It also encompasses the concept of corporate social responsibility (CSR). However, 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 MNEs to enhance their own sustainability, as it contributes to revenue, mitigates risk and increases overall enterprise value (Loewendahl, Kollinsky and van den Berghe, 2017). In particular, these two rationales for sustainability enhancement of MNEs, the following strategy suggestions for attaining or increasing firm sustainability can be considered, in particular:

1. How can sustainable development practices increase company revenues and enterprise value?
  - (a) Maintain a competitive position – keep up with competitors who adhere to, and actively promote higher standards;
  - (b) Differentiate products – differentiate products or services to gain a 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 who share common values on sustainability;
  - (d) Increase employee loyalty – recruit, retain and motivate employees who share these values of sustainability.
2. How can sustainable development practices mitigate risks?
  - (a) Preserve a licence to operate – mitigate the risk of disruption in 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 the 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 of suppliers, especially smallholders.

The concept of sustainable FDI is further explored in chapters 6 and 7, while the impacts of FDI on economic and sustainable development are discussed in chapter 7.

## F. Digital foreign direct investment<sup>8</sup>

The digital economy is becoming an ever more important part of the global economy. It is revolutionizing the way we conduct business, and it has important implications for FDI and, more importantly, digital FDI. However, the literature on digital FDI is characterized by numerous different expressions, many of which lack a clear and shared definition.

A first element of definition was provided by the World Economic Forum (WEF), which defines digital FDI as “FDI in the digital economy”. In other words, digital FDI is about attracting investment to grow the digital economy.

Just like traditional FDI, digital FDI invests abroad in order to be close to customers, access local knowledge, open new markets and more. Yet, FDI in the digital economy can especially bring additional knowledge, technology, jobs and growth to countries. Furthermore, digital MNEs have business models that vary from traditional brick-and-mortar businesses. Since digital products and services use relatively few natural resources or cheap labour, digital firms rely heavily on platform economies and leverage non-traditional assets.

For better comprehension, an elaboration of what the digital economy actually means, and how it changes the understanding of FDI and its impact, is in order.

UNCTAD’s *World Investment Report 2017: Investment and the Digital Economy* defines the digital economy as “the application of Internet-based digital technologies to the production and trade of goods and services.” More simply defined, the digital economy encompasses any transaction that is conducted over the Internet. This could range from a video call to one’s grandmother, to the digital purchase of an interesting pop song, the virtual negotiation of a multibillion-dollar deal, or a digitally controlled factory automatically producing cars.

As explained by Deloitte (2019), the digital economy is “the economic activity that results from billions of everyday online connections among people, businesses, devices, data and processes...The backbone of the digital economy is hyperconnectivity, which means growing interconnectedness of people, organizations and machines that results from the Internet, mobile technology and the internet of things (IoT).” Since the digital economy is fundamentally predicated upon data-enabled connectivity, it could

not exist without the Internet. For this reason, other popularly used terms for the digital economy are the Internet Economy and the Web Economy, although it is sometimes also alluded to as the Knowledge Economy.

While the Internet is the technological spine of this economy, its current rapid growth is being fuelled by dramatic advances in six digitally enabled frontier technologies: cloud computing, artificial intelligence and data analytics, automation and robotics, blockchain, additive manufacturing, and the Internet of Things (UNCTAD, 2019; UNIDO, 2020). All run on Internet connectivity.

Working in combination, these digitally-enabled technologies have created such historically unprecedented technological capability that experts feel they have unleashed a Fourth Industrial Revolution (4IR) – one that will accelerate with continued leaps in digital connectivity and master computing. This 4IR will upend the way in which the world economy is organized, much as occurred following the invention of mechanization and the steam engine (First Industrial Revolution), electricity and mass production (Second Industrial Revolution), the personal computer and the Internet (Third Industrial Revolution) (UNCTAD, 2019; UNIDO, 2020).

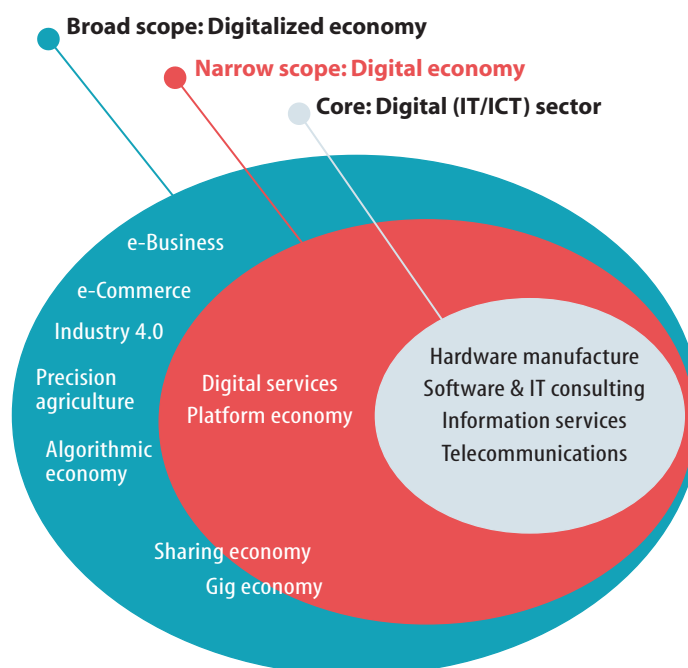
Structurally, as shown in figure 1.3, the digital economy comprises three distinct layers (UNCTAD, 2019). At its core is the physical infrastructure of telecommunications and the Internet (including telecom towers, fibre-optic cable, telephones, mobile phones, computers and laptops), inextricably intertwined with the software that gives it life (including Internet connectivity, encryption systems, order management applications, and financial and payment applications). Riding on this core is the digital and information technology sector, which harnesses digital devices and digital connectivity to develop and deliver software applications and digital offerings to the broader economy, which is the outermost layer of the digital economy. This layer encompasses the myriad consumers, businesses, governments and institutions worldwide that use the digital connectivity, products and services generated by the underlying two layers in daily life and operations.

The more innovative the core and intermediate layer are, the more the broader economy develops. In turn, the more that the broader economy harnesses advanced digital technology and applications, the more that existing patterns of production and consumption are likely to evolve.

<sup>8</sup> This chapter is based on a paper prepared for ESCAP by Premila Nazareth Satyanand, titled: “Foreign Direct Investment and the Digital Economy”.



The structure of the digital economy



Source: UNCTAD, Digital Economy Report 2019.

In addition, the rapid expansion of the digital economy is driving an elemental change in the structure and geography of the world economy as it creates new kinds of global economic value, and directs it to a set of companies and countries that differ from the past. Digital firms' FDI lightness (box 1.6), and their reliance on local networks and partners, has made it possible for them to scale globally at unprecedented speeds. For example, while it took Marriott Hotels nearly a century to reach 122 countries, Airbnb needed just eight years to begin operating in 190 countries (Banalieva and Dhanaraj, 2019).

“The rapid rise of tech MNEs represents one of the most noteworthy trends in the world of global mega-corporations in recent years. Tech MNEs have not only gained weight in the universe of the largest global multinationals, they also represent by far the most dynamic players” (Casella and Formenti, 2018). These MNEs and their founders now cluster at the top of international rankings, including Fortune 500, Forbes' Global 2000 and World Billionaires List.

UNCTAD's annual ranking of the world's 100 largest MNEs shows a similar trend. In 2020, it contains some 15 tech firms – some of which are now global mega-corporations – up from four in 2010. They are also the most economically dynamic; these 15 firms' assets grew by 11 per cent a year between 2010 and

2015 (i.e., 65 per cent in total), more than 10 times faster than that of other MNEs. Their operating revenue and employment expanded by some 30 per cent. In 2019, their foreign assets represented 11 per cent – and their foreign sales 18 per cent – of the total for the world's 100 largest MNEs. Just 10 of them – including Alphabet (Google), Apple, Microsoft, Hon Hai, SAP and Sony – accounted for a quarter of the total market capitalization of all 100 firms in UNCTAD's list (UNCTAD, 2017).

However, the continued global expansion of digital platforms and the digitalization of traditional sectors is likely to transform international production during the coming decade, according to experts (UNCTAD, WIR 2020). This evolution will both shape – and be shaped by – global FDI flows, as MNEs employ digital technology and modes of organization to outcompete each other. Experts foresee several trends:

**Retrenchment:** As explained above, digital MNEs' 'asset lightness' permits them to operate globally with minimal foreign assets. Thus, their foreign investment volume is smaller than that of counterparts in traditional sectors, which have typically driven global FDI these past few decades. Thus, the more dominant digital firms become internationally, the more 'interference' they will create in existing FDI patterns, which have generally displayed a steady upward trajectory over the past



### The FDI Lightness Indicator

UNCTAD has devised a new measure – the ‘FDI lightness indicator’ – to gauge the foreign asset-intensity of digital economy MNEs. Applying this indicator to its list of the world’s 100 largest digital MNEs<sup>9</sup> and the 100 largest ICT MNEs,<sup>10</sup> UNCTAD finds that the more that a firm relies on the Internet to create, produce, market and distribute its goods or services, the higher its score on the FDI lightness indicator. In other words, they sell more overseas from smaller foreign assets.

Individual firms’ scores are calculated by deriving the ratio between foreign sales (as a percentage of total sales) and foreign assets (as a percentage of total assets). If the score is between 0 and 1, it means the firm needs more foreign assets to make a certain quantum of sales. If the score is over 1, the firm’s foreign sales rely less on foreign assets. With a rising score, the firm’s foreign sales are increasingly liberated from foreign assets.

While this indicator was developed for digital economy firms, UNCTAD finds it also works as effectively for other types of MNEs. More importantly, it also serves to predict how large a firm’s relative global FDI footprint is likely to be when compared to others. The lower a firm’s ‘FDI lightness’ score, the more it will need to invest in foreign operations. The higher it is, the more effectively the firm can operate internationally from out of its home country.

*Source:* Adapted from Casella and Formenti, 2018.

century (UNCTAD, 2017). This same phenomenon will be evident among traditional sector firms, as they progressively digitalize (Casella and Formenti, 2018).

Experts thus expect to see a phenomenon they have called ‘FDI retrenchment’, in which the rising trajectory of global FDI will flatten or diminish, as the average size of foreign assets contracts – the more that digital MNEs expand and the more that other MNEs digitalize.

In parallel, experts foresee digitalization prompting traditional sector MNEs to restructure global operations and investment in the following ways (UNCTAD, 2020):

**Reshoring:** As AI-controlled automation and robotics expand, MNEs are likely to internalize hitherto outsourced international production operations and bring these home, in a process known as ‘reshoring’ and ‘insourcing.’ This trend is most likely to be seen in higher-technology sectors, such as machinery and equipment, electronics and automotive-related industries, where production is already quite mechanized, and supply chain resilience and intellectual property protection is critical. Some reshoring might also be experienced in less sophisticated service industries, such as retail, wholesale value chains, transportation and logistics,

as digital platforms control more international sales and marketing activity out of headquarters.

**Regionalization:** Some MNEs might regionalize value chains, by downscaling existing networks to be close to key customers, or by upscaling country networks to serve a regional market. Regional networks are generally seen in industries that are dependent on local raw materials, such as food, beverages and chemicals, or that need to be close to consumers because of the limited shelf life of products.

**Replication:** Some MNEs might choose to distribute their manufacturing operations internationally in centrally-controlled networks of automated manufacturing hubs, producing standardized products near end consumers. In this model, called ‘replication,’ MNEs are more likely to outsource the digitally controlled, standardized production of key products to local contractors, than to make major investments in manufacturing facilities themselves. However, product and system design, and network coordination, would be conducted out of the MNE headquarters.

**Diversification:** As touched on above, supply chain digitalization could propel MNEs into further diversification and geographical expansion of their value chains, to make these more resilient. In parallel,

<sup>9</sup> UNCTAD’s listing of the world’s 100 largest digital MNEs is available at [https://unctad.org/system/files/official-document/wir2017ch4\\_Annex\\_en.pdf](https://unctad.org/system/files/official-document/wir2017ch4_Annex_en.pdf) (see pages 8 and 9).

<sup>10</sup> UNCTAD’s listing of the world’s 100 largest ICT MNEs is available at [https://unctad.org/system/files/official-document/wir2017ch4\\_Annex\\_en.pdf](https://unctad.org/system/files/official-document/wir2017ch4_Annex_en.pdf) (see pages 10 and 11).

digitalization facilitates the outsourcing of more sophisticated services, due to advances in teleworking and translation software.

As a result, these trends could result in an FDI 'de-democratization', that is, a slowing or reversal of the recent FDI surge to developing countries, as FDI once again concentrates in developed economies (Casella and Formenti, 2018).

Moreover, given the 10 per cent ownership threshold of FDI as well as the financing mechanism of FDI is different (i.e., venture capital), there are more and more cases – especially in relation to digital technologies, in which strictly speaking a foreign investment is not qualified as FDI but does have a similar impact as the case study shows in box 1.7.



### Joint venture culture and FDI/FPI conundrum: Case of Jio Platforms

The Government of India now uses the internationally agreed '10 per cent rule' in distinguishing between FDI and FPI where – according to the International Monetary Fund's 10 per cent rule – any equity investment below 10 per cent is counted as portfolio investment and any investment above 10 per cent as FDI. However, relying on this formula alone might not properly capture the real quantum of FDI flows.

Consider Walmart's famous joint venture with Bharti; the United States largest retailer entered India in 2008 via a 50-50 joint venture with Indian conglomerate Bharti Enterprises. While the joint venture lasted only for a few years before being called off, the 50 per cent stake clearly defined Walmart's investment as an FDI. In June 2014, the Ministry of Finance clarified the definitions of FDI and FII flows; FDI equivalent to 10 per cent of equity and above is to be counted as FDI and that below 10 per cent as foreign portfolio investment. However, the line between FPI and FDI can be thin. Even if Walmart invested less than 10 per cent stake in Bharti Retail, there would be a high probability that it would strategically partner with and guide the business, bringing its own global business strengths to the joint venture and the host economy. Thus, this would not be a purely 'financial' or portfolio investment, but more in the nature of FDI. Conversely, if a private equity firm invests more than 10 per cent in a supermarket chain like Bharti, a PE investor will have neither the interest nor ability to contribute any practical support to the real-world firm in which it is investing. So, it would/could not partner the business in the manner of a traditional FDI investor (Nazareth Satyanand, 2016). While these explanations remain purely theoretical examples, we found a real case with Jio Platforms, India's largest telecom platform.

The digital subsidiary of Reliance Industries has received several overseas investments from leading technology investors over the past year. In 2020, Facebook bought a 9.99 per cent stake in Jio (worth about US\$5.7 billion) as it marks the largest investment for a minority stake by a technology company anywhere in the world. Google, for its part, bought a 7.73 per cent stake (worth about US\$4.5 billion). In 2019, the Securities and Exchange Board of India (SEBI) established a new FDI/FPI classification; with the change in rules that if a foreign fund buys less than a 10 per cent stake in a company, such an investment will be considered FPI regardless of the route chosen. Conversely, if the ownership of an FPI in a company crosses 10 per cent, such an investment would be considered FDI. Therefore, in both cases, the 10 per cent ownership threshold has not been crossed, so it should be technically qualified as FPI. However, the two digital giants are still going to have significant collaboration/partnerships with Jio, making those investments FPIs technically but FDIs in spirit as these investments seem long term.

In the wake of Google and Facebook's investment plans in Reliance Jio, FDI should not only be distinguished from FPI by the '10 per cent rule'. The government should assess the nature and purpose of each underlying investor before consigning it to the FDI or portfolio category, else there could be miscounting between the two categories. Hence, Indian government and policymakers are requested to adopt a more agile and flexible approach in identifying and regulating foreign investments.

*Source:* Nazareth Satyanand, 2020.

## G. Issues for discussion

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. To what extent is round-tripping a problem in your country? Is it being addressed?
5. Do you think FDI in your country contributes to sustainable development? Is FDI itself sustainable?
6. Which other drivers of FDI do you see emerging in your economy?
7. Does the concept of digital FDI also apply for your country?
8. How do you define sustainable FDI in your FDI targeting and promotion efforts?
9. Is your country increasingly focusing on sustainable FDI?
10. 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?
11. To what extent do you think the principles of good governance are applied in your country/locality?

## CHAPTER



# Foreign direct investment trends and impacts

## A. Foreign direct investment developments and trends

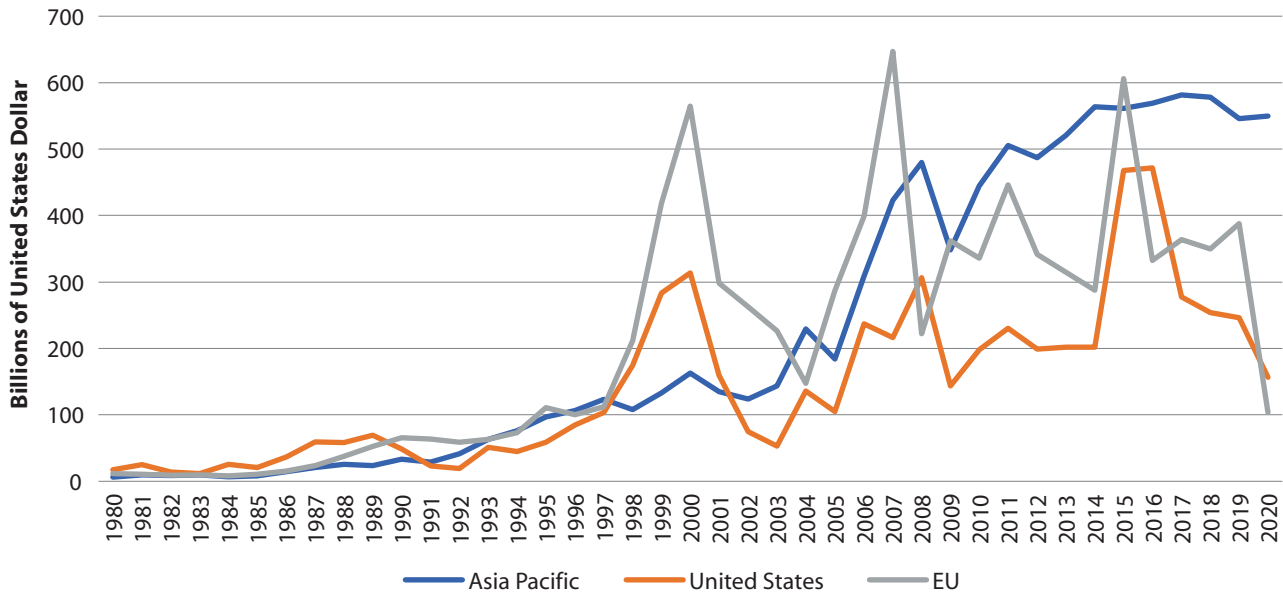
### 1. Global and regional trends in inward foreign direct investment flows<sup>1</sup>

One of the major developments in FDI in the past four decades has been the dramatic increase in global FDI flows, from US\$52.1 billion in 1980 to US\$1 trillion in 2020. This is notwithstanding notable dips in total inflows in the aftermath of the 1998 financial crisis, the 2008 global economic crisis as well as a slowdown in FDI growth since 2014 and in the aftermath of the COVID-19 pandemic in particular. 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. Overall, the region has continuously increased its share of the global FDI inflow, reaching 54 per cent of global inflows in 2020 (figure 2.1). A major contributor to this changing geographic pattern of FDI flows has been China, which has become the largest developing country in the world to attract FDI flows over the past three decades, even surpassing the United States in 2014. (However, in 2015, the United States again was in the leading position, with a tremendous surge in mergers and acquisitions, or M&As) (figures 2.1, 2.2 and 2.8).

<sup>1</sup> Trends in outward foreign direct investment are addressed in chapter 3.

**Figure 2.1**

**FDI inflows to world regions, 1980-2020**



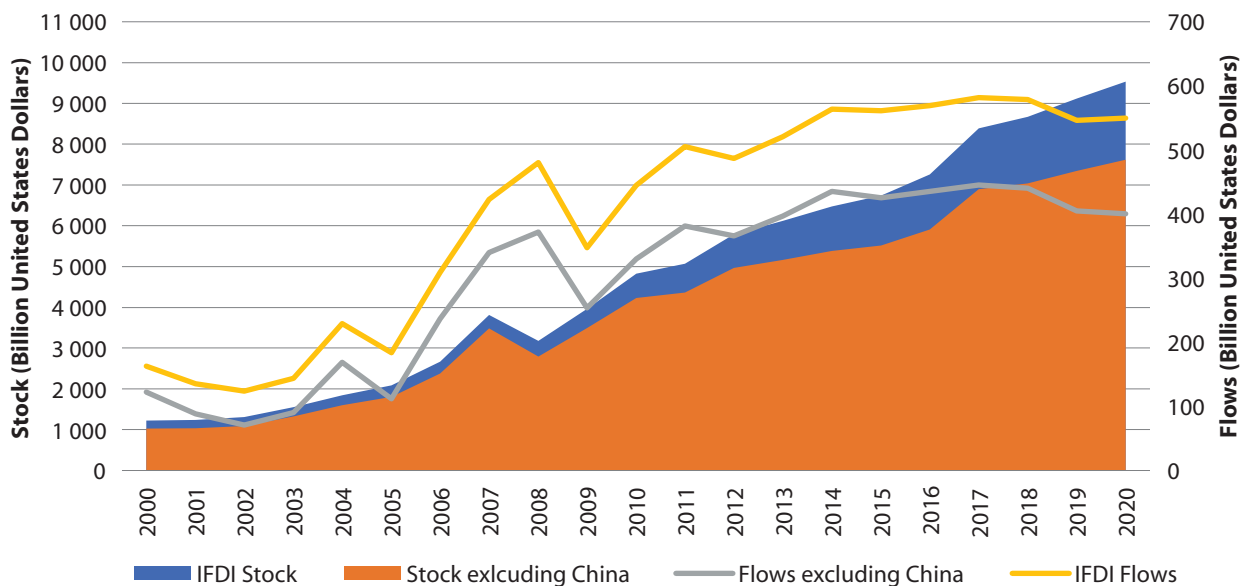
Source: ESCAP calculation, based on UNCTADstat (2021).

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 that address liberalization, facilitation and promotion of FDI. This is also reflected by the recent accession to the WTO of various least developed and landlocked developing countries of the region (e.g., Afghanistan,

Kazakhstan, Kyrgyzstan, Lao People’s Democratic Republic and 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.

**Figure 2.2**

**Asia and the Pacific inward FDI flows and stock, 2000-2020**



Source: ESCAP calculation, based on UNCTADstat (2021).



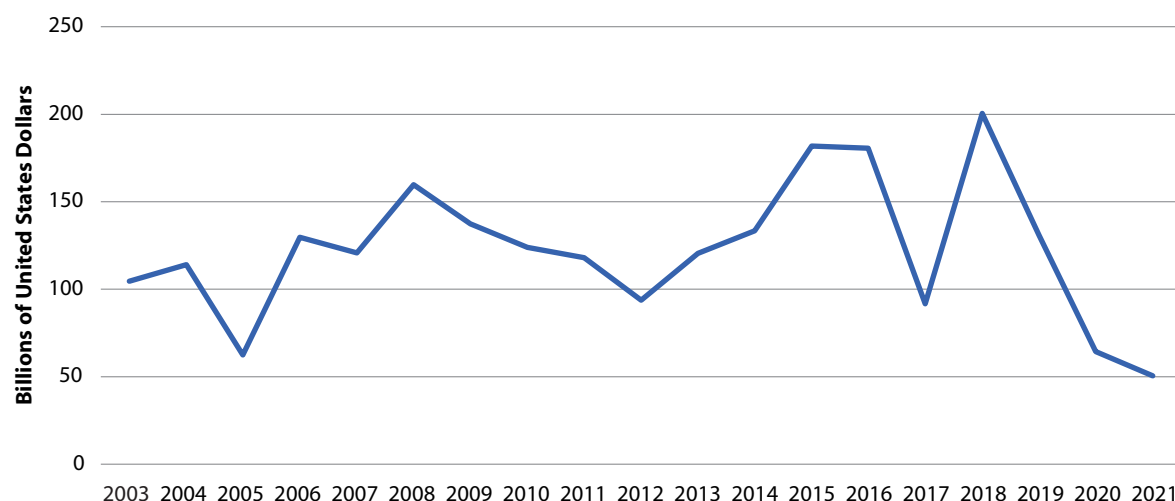
While greenfield FDI, an important indicator for future FDI trends, to the region has dropped from its highs in the mid-2000s, recently modest increases can be noted (figure 2.4), although inflows continue to be relatively volatile. The largest recipient economy between 2003 and 2020 was China,<sup>2</sup> followed by India, Australia, Viet Nam, the Russian Federation and Indonesia. In general, emerging Asian economies tend to receive more greenfield investments, while the richer economies in the region – including Australia, Japan and New Zealand – rank higher in M&As. Interestingly, with rising FDI inflows and improving development, FDI outflows, or OFDI, from the region have also risen (see chapter 3 for more details on this trend). This development began in the late 1960s when Japan emerged as a major overseas investor and has continued throughout the 1980s as Hong Kong, China, the Republic of Korea and Singapore experienced significant economic growth. More recently, China and India have become major

investors in their own right, predominantly in the other developing countries in the region and beyond.

With the emergence of new investors, intraregional FDI flows began to grow in significance, with the share of intraregional greenfield inflows in total FDI inflows increasing from 32 per cent in 2003 to 47 per cent in 2020. In absolute numbers, albeit fluctuating, intraregional FDI inflows have grown steadily since 2003, reaching an all-time high in 2018 of US\$200 billion (figure 2.3). ASEAN members are the major recipients of such flows, while the East and North-East Asian and South-East Asian subregions constitute the largest sources, accounting for 63 per cent and 22 per cent, respectively, of intraregional greenfield flows over the past decade. Overall, this emerging pattern of intraregional FDI inflows suggests that the Asia-Pacific region is becoming increasingly integrated with itself than with other regions in the world.



**Intraregional greenfield FDI: Asia-Pacific, 2003-2021**



Source: ESCAP calculations, based on fDi Intelligence data (2022).

The COVID-19 pandemic caused FDI levels to plummet by 42 per cent in 2020, with greenfield FDI in Asia and the Pacific dropping to its lowest level in four years, to US\$135 billion (figure 2.4). Developing countries in the region have been disproportionately affected because sectors that were severely affected by the pandemic, including the primary and manufacturing sectors, account for a larger share of their FDI than in developed economies.

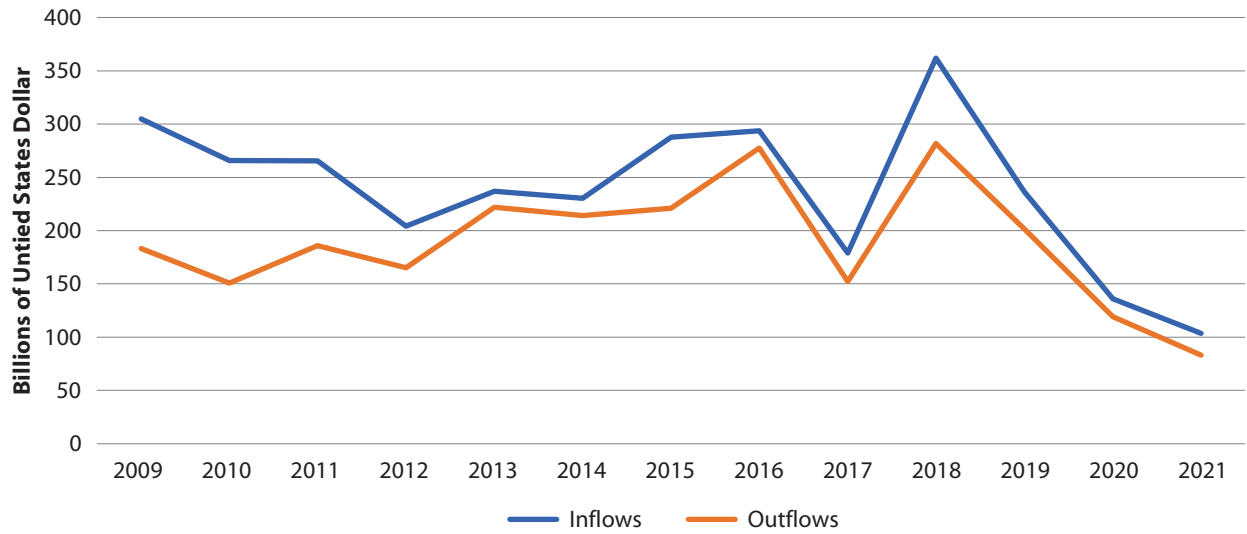
In terms of the sectoral distribution of greenfield FDI inflows to the Asia-Pacific region, greenfield

investments have grown more steadily for services relative to manufacturing since the 2000s (figure 2.5). Illustrating this, the services sector accounted for 39 per cent of all inward greenfield FDI in the 2006-2009 period compared to 47 per cent during 2016-2020. This growth has mostly been driven by increased investments in real estate and renewable energy, in combination with plummeting greenfield investments in the primary sector. Greenfield FDI in renewable energy is likely to continue to grow during the next five years, thanks to the rising Asia-Pacific population, economic growth and currently small

<sup>2</sup> Includes Hong Kong, China and Macao, China.

**Figure 2.4**

**Greenfield FDI inflows and outflows, Asia-Pacific, 2009-2021**



Source: ESCAP calculation, based on fDi Market data (2022).

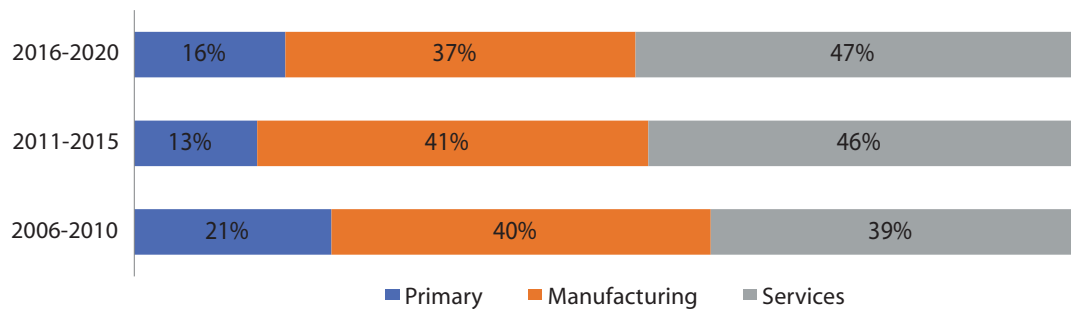
installed capacity, and as some major economies in the region have pledged to achieve carbon neutrality<sup>3</sup> during the coming decades.

More recently, the growing importance of ICT and digital MNCs as well as the gradual adoption of digital technologies by traditional manufacturing and service MNCs to streamline their operations has propelled digital FDI in communications, software and IT services. The COVID-19 pandemic has pushed businesses further towards digitalization which, in combination with a growing trend towards automation, will accelerate digital FDI across the

region and beyond. In addition, traditional motivations for market-seeking FDI and resource-seeking FDI might be partially undermined as other types of FDI gain in importance. Among them, knowledge-seeking FDI and, to a lesser extent, financial- and tax-driven FDI. Such new investment patterns may affect MNC’s international production footprints, with important implications for the host countries’ economic development. In particular, MNCs in highly digitalized sectors are expected to have an asset-light footprint, retaining the largest interest in (developed) home countries (Casella and Formenti, 2018).

**Figure 2.5**

**Sectoral distribution of greenfield FDI inflows to the Asia-Pacific region, 2006-2020**



Source: ESCAP calculation, based on fDi Markets data (2021).

<sup>3</sup> China, Japan and the Republic of Korea have all pledged to become carbon neutral, – China by 2060 and the other two countries by 2050.

Greenfield investments in the manufacturing sector have stabilized at a relatively high level in the 2000s. This occurred after having experienced a significant uptick following the structural shift in the FDI composition away from traditional market-seeking (import substitution) towards efficiency-seeking (export-oriented) activities in the mid-1970s and at an accelerated pace in the 1990s. This has prompted the relocation of significant phases of production by MNCs to the Asia-Pacific region where production costs are low, and abundant labour is available, thereby enabling the region to outpace other developing regions in attracting efficiency-seeking FDI. More recently, within the efficiency-seeking domain, FDI flows related to assembly process within vertically integrated global industries (in particular, electrical goods and electronics) have gained prominence over those related to traditional labour-intensive manufacturing. This process was intrinsic to the development of China as well as the newly industrialized economies in Asia and the Pacific, and is now shifting to other lower-cost countries in the region. Although China continues to attract the largest share of global FDI flows to the Asia-Pacific region, rising wages have gradually weakened the country's comparative advantage in the labour-intensive manufacturing sector. This has led to companies to relocate some of their GVC production stages to low-wage countries, predominantly in South-East Asia (Cai, 2012) (see box 2.1). This shift is further exacerbated by the ongoing United States-China trade tensions and supply chain disruptions caused by the COVID-19 pandemic.

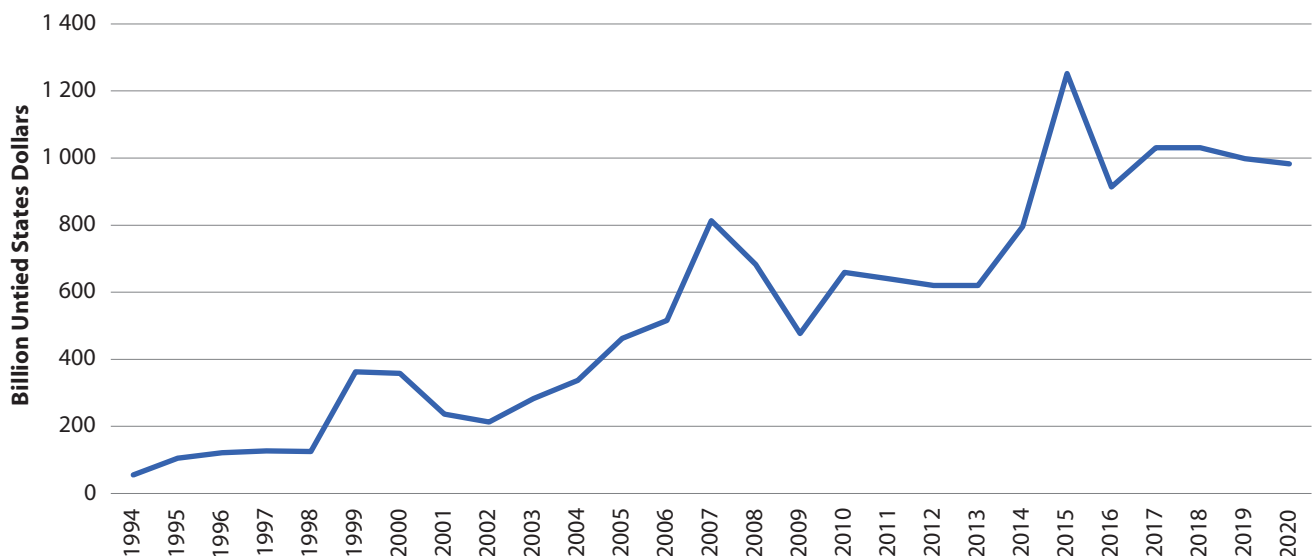
However, greenfield FDI and M&As in manufacturing both declined in 2011-2015, mainly driven by a fall in investment from outside Asia and the Pacific in the years after the global financial crisis. A similar trend is observed for natural resources, where investments from within and outside Asia decreased both at extensive and intensive margins, and for both modes of entry. This is consistent with the commodity price shock that followed the crisis and dampened investment demand.

A similar trend is observed for natural resources, where investments from within and outside Asia decreased both at extensive and intensive margins, and for both modes of entry. This is consistent with the commodity price shock that followed the crisis and dampened investment demand (ADB, 2016).

FDI flows through M&As in the Asia-Pacific region have continuously grown over the past two decades (figure 2.6). Despite plummeting during economic downturns – for example, in the dot-com crash (2000-2001) and the financial crisis (2008-2010) – total value of cross-border M&A deals increased 18 times from 1994 to 2020, from US\$55 billion to US\$982 billion. Even with the COVID-19 pandemic, the Asia-Pacific region has remained an attractive market for M&As. Illustrating this, M&As only moderately declined by 1.5 per cent (in value) in the Asia and Pacific region in 2020, compared to the 10 per cent decline witnessed globally. The strong performance of China, where cross-border M&As rose by 54 per cent amid the pandemic, contributed



**Figure 2.6** FDI flows through M&As in Asia and the Pacific, 1994-2020



Source: ESCAP calculation, based on Refinitiv Eikon (2021).

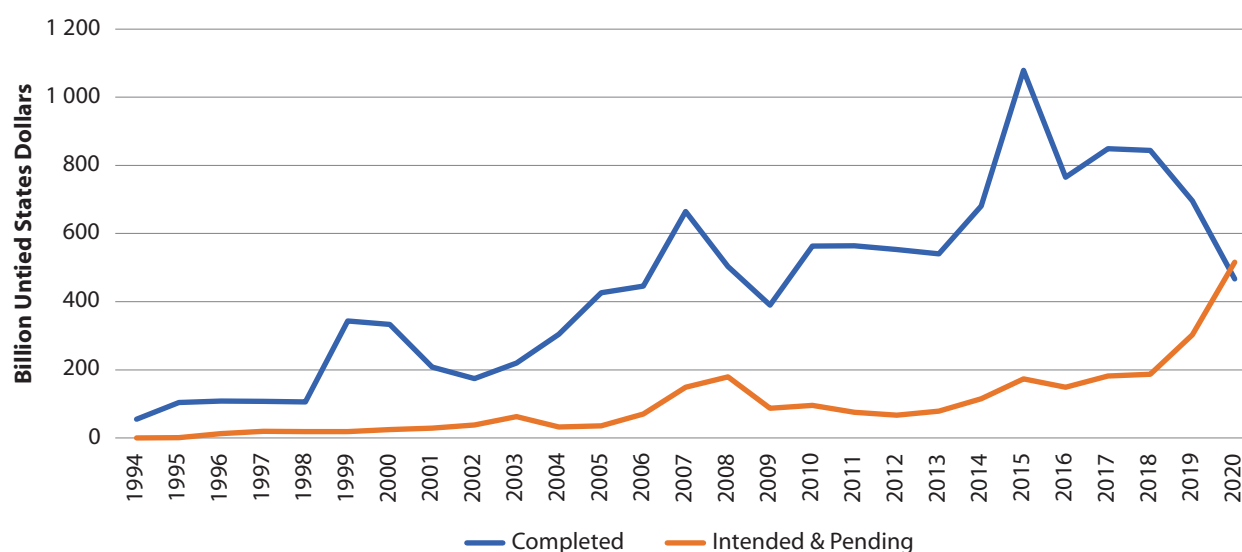
the most to the quick rebound of M&A sales in the Asia-Pacific region. The resiliency of the Asia-Pacific region highlights the extent to which it will be a critical driver of recovery in the post-pandemic period.

Yet another story presents itself when looking at the completed versus pending M&As in the region. Since 2018, expenditure on completed M&As has decreased sharply, while for intended and pending projects it has increased (figure 2.7). Rising protectionism accompanied by stricter FDI screening mechanisms, downward pressure on the global

economy and ever-intensified geopolitical conflicts have made buyers ponder their decisions. As the United States-China trade war escalated, 41.9 per cent (in volume) of the inbound M&As in China were put on hold in 2019, compared with 28 per cent in 2018. The COVID-19 pandemic further postponed the execution of M&As, and approximately 53 per cent of the total investment in Asia-Pacific was put on hold. Prolonged negotiations due to remote communication, increased cautiousness of buyers, and delayed regulatory approvals extended project timelines.



**Figure 2.7** FDI flows through M&As in Asia and the Pacific by implementation status, 1994-2020



Source: ESCAP calculation, based on Refinitiv Eikon, (2021).

## 2. Subregional trends in foreign direct investment inflows

Among all the subregions in Asia and the Pacific,<sup>4</sup> East and North-East Asia and South-East Asia have attracted the most FDI as countries liberalized their economies and continued to improve their business and investment climate. FDI has been mostly attracted to 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 been aimed at countries such as India, Malaysia and Singapore (ESCAP, 2015).

A country-level distribution highlights the fact that China has been the largest recipient of FDI, attracting 27 per cent of regional flows in 2020 although FDI inflows as a percentage of GDP have steadily declined, suggesting that the importance of FDI in China has weakened over time relative to the size of the domestic market.<sup>5</sup> China's attractiveness as an FDI host is even more apparent when looking at FDI stock, for which the country accounts for 45 per cent of total FDI in North and East Asia, up from around 20 per cent at the turn of the century. Although Hong Kong, China still accounts for 44 per cent of total stock in the subregion, its relative importance has declined considerably as it accounted for 80 per cent throughout the 1990s. The shares of both Japan and

<sup>4</sup> ESCAP distinguishes the following subregions: East and North-East Asia, South-East Asia, South and South-West Asia (including the Islamic Republic of Iran), North and Central Asia, and the Pacific.

<sup>5</sup> In 2005, China recorded an inflow of US\$72 billion, which accounted for 58 per cent of total inflows into Asia and the Pacific. Although the country received significantly more FDI in 2015 (US\$ 145 billion), its share in total inflows decreased to 39 per cent. Similarly, whereas inward FDI made up 3.2 per cent of GDP it fell to 1.1 per cent in 2015.

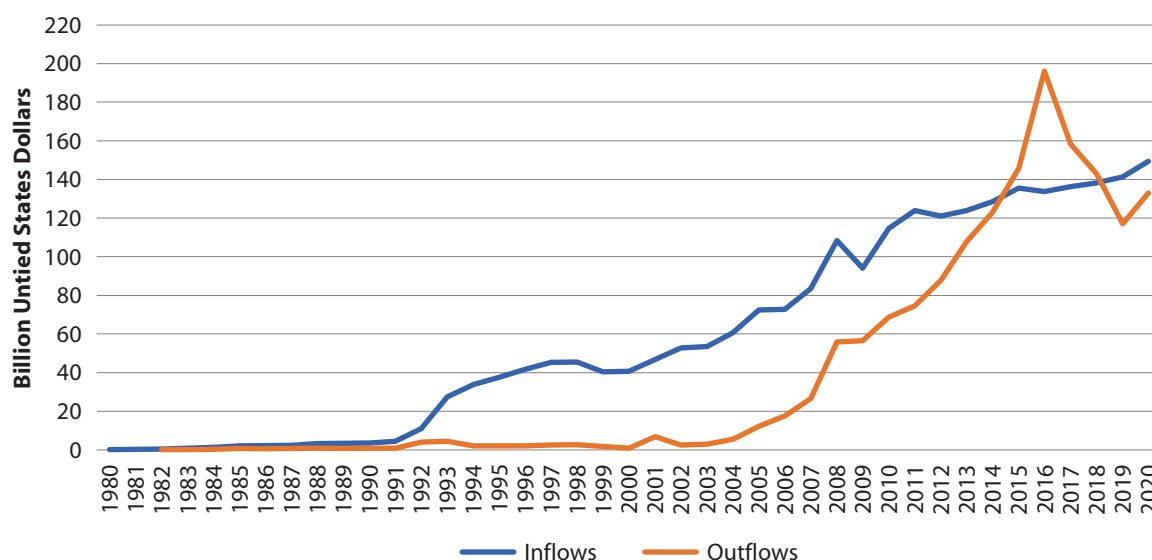
the Republic of Korea have remained relatively stable over the past decade, making up for 7 per cent and 6 per cent, respectively, of the total FDI stock in the subregion, respectively.

Interestingly, trade frictions and lower levels of global FDI from 2018 onwards have not hampered inward investment levels to China as whole. On the contrary, inward FDI reached a record-high US\$149 billion in 2020 (figure 2.8), despite the COVID-19 pandemic. Rising labour productivity, together with the country's advanced infrastructure and effective participation in GVCs, has enabled China to continue to attract FDI, especially in capital- and technology-intensive

sectors and supply chains. This makes it a prime example of the potential for FDI to contribute to development. At the same time, however, rising wages have gradually weakened the country's comparative advantage in the labour-intensive manufacturing sector, leading companies to relocate their production facilities to low-wage countries, predominantly in South-East Asia. As these production networks have spread to other countries in the region, intraregional trade and FDI inflows in those countries have risen considerably. Following in the footsteps of China, the most recent success stories in terms of FDI are Indonesia and Viet Nam (box 2.1).



**FDI inflows and outflows: China, 1980-2020**



Source: ESCAP calculation, based on UNCTADstat (2021).

While China has emerged as a leading destination for FDI, since the mid-2000s it has also become a significant source of global and regional FDI flows. This trend also coincided with the enactment of a series of investment liberalization reforms to prepare for its accession to the WTO. Initially these flows were of the resource-seeking nature and aimed at smaller economies in the Asia-Pacific region, but increasingly they have shifted towards being more strategic-asset seeking (M&As), and have been aimed at access to technologies and skills in higher developed countries. Continued reforms and the global financial crisis sustained this growth in OFDI, leading China to become the world's second-largest outward investor after the United States in 2016, with US\$196 billion of OFDI.

ASEAN is also a large recipient of FDI, with MNCs being attracted by its growing regional market, natural resources and ability to be a base for export-oriented production. The latter point in particular has been driven by ASEAN's integration into East and North-East Asia supply chains and production networks. In addition, the subregion's attractiveness as an FDI host is not only a product of globalization but also regional integration, which has been pursued through the ASEAN Comprehensive Investment Agreement and the establishment of the ASEAN Economic Community in 2015, among other reasons. In addition, it is expected that FDI to ASEAN members that have signed on to the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and Regional Comprehensive

Economic Partnership (RCEP) agreements will be boosted through their entry into force (see box 2.2 for more information on these Agreements).

FDI inflows to the subregion first began to take off in the late 1980s. The Asian financial crisis in 1997/1998 and the dot-com crash in the early 2000's led to a temporary decline in inward investments before they started to pick up again in 2003. Although the global financial crisis led to a renewed downfall of FDI inflows in 2008 and 2009, the past decade has seen a rapid recovery, with inflows averaging US\$140 billion over the past five years – more than 50 times higher than in 1980, and accounting for about one-third of total inflows into the Asia-Pacific region.

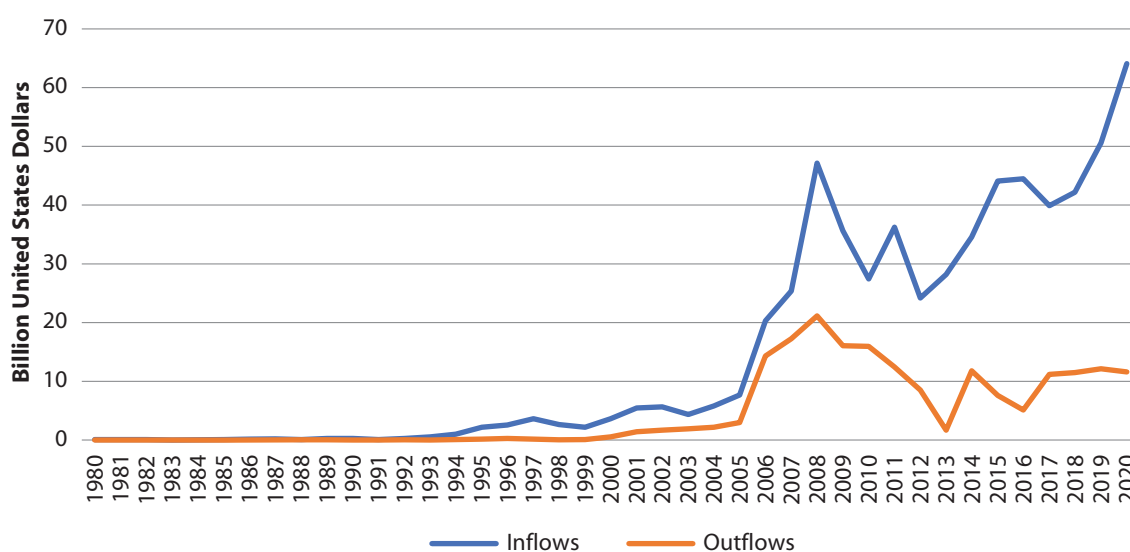
Correspondingly, the ASEAN members have seen their accumulated FDI stock grow considerably during the past 20 years. In 1980, this stock amounted to around US\$17 billion, but it subsequently increased to US\$258 billion by 2001, and currently stands at US\$2.9 trillion. In addition, FDI inflows have gradually become more important for the economy as reflected in the share of inward FDI stock to GDP ratio, which stood at 9 per cent in 1980, growing to 29 per cent in 2019. However, inward FDI flows declined considerably in 2020 (by 25 per cent), largely due to significant contractions in Singapore, Indonesia and Viet Nam related to the COVID-19 pandemic (UNCTAD, 2021). Although all ASEAN

members have experienced a marked increase in their FDI stock over the past 20 years, FDI inflows are unevenly distributed among them. The total stock of FDI is mostly concentrated around the ASEAN-6<sup>6</sup> with a total value of US\$2.8 trillion, representing more than 96 per cent of total FDI in ASEAN. Singapore, in particular, has been a preferred destination country, attracting a total of US\$1.8 trillion, amounting to 62 per cent of total FDI in the subregion. However, the distribution of FDI stock in ASEAN is gradually shifting, most noticeably so in the Greater Mekong Subregion (GMS) transitional economies,<sup>7</sup> which only began to seriously attract FDI from the mid-1990s onwards.

India and other South Asian countries have continued to remain under-performers in attracting FDI. However, the mid-1990s saw a marked increase in FDI to India, a trend that represents a clear break from the preceding decade (figure 2.9). As a result, the country's FDI inflow has risen considerably and now accounts for 60 per cent of total FDI in the South and South-West Asian subregion. Notwithstanding these increases, total annual FDI inflows to India in 2020 (US\$64 billion) only amounted to 42 per cent and 47 per cent, respectively, of those into China and ASEAN. In terms of outflow, following liberalization reforms they started to grow quickly in the mid-1990s, experiencing a significant surge since about 2005 following significant dismantling of foreign exchange restrictions on capital transfers for the



**Figure 2.9** FDI inflows and outflows: India, 1980-2020



Source: ESCAP calculation, based on UNCTADstat (2021).

<sup>6</sup> Indonesia, Malaysia, the Philippines, Singapore, Thailand and Viet Nam.

<sup>7</sup> Cambodia, the Lao People's Democratic Republic, Myanmar and Viet Nam.

acquisition of foreign ventures by Indian firms during 2000–2004 (Athukorala, 2009). Many investors during that period financed their expansions by taking on debt on international capital markets which, after the 2008 financial crisis, became increasingly difficult to service. As a result, OFDI flows from the subregion experienced a large drop from US\$20 billion in 2008 to US\$1.6 billion in 2013, and have yet to recover to pre-2008 levels.

Regionally, the majority of FDI inflows are unevenly distributed within the ASEAN-6 countries – China, Hong Kong, China, Japan, India, and the Republic of Korea – receiving the largest volume and value of FDI, while LDCs and LLDCs in Asia and the Pacific in general have received much less investment. LDCs and LLDCs account for less than 1.6 per cent and

2.4 per cent of total regional FDI inflows, respectively, despite the steady increase during the past 30 years. These countries have often attracted FDI in the natural resources sector,<sup>8</sup> which can pose additional challenges to the management of investment revenue and resources. LDCs such as Bangladesh and Cambodia rely on FDI in labour-intensive industries, such as textiles and garments, which dominate their economies.<sup>9</sup>

In addition, ESCAP's Asia-Pacific Trade and Investment Trends reports also provide a regional and subregional overview and analysis of FDI inflows and outflows as well as an update on investment policy trends in Asia and the Pacific. The reports can be accessed at <https://www.unescap.org/knowledge-products-series/APTIT>.



### Reshoring of FDI

Beginning in the early 1990s, offshoring – i.e., the location of a company's processes or services outside the home country – has emerged as one of the most widespread strategies implemented by manufacturing and, increasingly, services companies in developed countries in order to sustain or promote their competitive advantage. By splitting up their value chain into distinct parts, some of which are kept in-house and others outsourced and often offshored, a company hopes to reap cost benefits mostly due to lower wage costs in foreign locations. At stake are not only low-end manufacturing and services activities, but more recently also high-value functions including design, engineering, and R&D (Contractor and others, 2010).

Although offshoring to Asia and the Pacific is still a dominant strategy for many companies, and far from petering out, in the past decade a counter trend has emerged; many companies that had for many years offshored their production have started returning full or part of the production from fully-owned facilities in foreign locations to: (a) the company's domestic site (reshoring) or to another country that is either closer to the home country (nearshoring) or (b) has lower production costs (further offshoring) (Di Mauro and Fratocchi, 2018; Kinkel and Maloca, 2009). This phenomenon has been driven by a strategic rethinking among many MNCs. Companies are now considering the design of their supply chains as a dynamic capability with ongoing changes to where they source production.

In addition, many scholars point out that companies have started to focus more on unexpected factors such as the reliability of supply chains and strategic factors, including the issue of brand reputation and ethical consideration. Consequently, many companies have recalibrated their risk/benefit-balance, not only taking into account the estimated cost offshoring but also those incurred from the unexpected costs. As such, they no longer rely solely on cost aspects of the production (Moradlou and Backhouse, 2016).

Reshoring or the relocation of FDI is also occurring due to the rise of labour costs in certain countries in the region, in particular in China where wages have grown 10–20 per cent annually during the past decade. This has an impact on labour-intensive GVC production stages in particular, some of which are migrating from China to lower-cost locations in Asia and the Pacific. South-East Asia, in particular, with its low labour costs and conducive business environment remains attractive, creating an opportunity for this subregion to follow in China's footsteps. This shift, together with the broader trend of FDI reshoring, is being further accelerated by the COVID-19 pandemic, which has been deeply disruptive for supply chains as businesses grapple with fluctuations in supply and demand, intermittent outbreaks in different parts of the world, and speculation about reshoring and reducing reliance on China.

*Source:* References that are mentioned in the text.

<sup>8</sup> For example, a large share of FDI inflows to Myanmar for the hydrocarbon sector, whereas the mineral and hydrocarbon sector plays an important role in Nepal.

<sup>9</sup> Detailed reviews of trends in FDI, both globally and regionally, can be obtained from the UNCTAD World Investment Reports at <http://unctad.org/en/pages/DIAE/World%20Investment%20Report/WIR-Series.aspx>

### 3. The relationship between FDI 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).<sup>10</sup> FDI can act both as a substitute and a 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 fell during the past three decades in most parts of the world, and as intra-firm trade between countries increased, a strong relationship was observed between foreign trade and FDI flows, including in the Asia-Pacific region. As a result, FDI has moved away from being considered a substitute for trade to a complement of it (Maiga and others, 2019, Wang and others, 2017; Xiong and Sun, 2019). 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 (Zaman and others, 2018; Saleem and Shabbir, 2020). This is particularly evidenced by the (efficiency-seeking type of) FDI-led expansion of GVCs that, in turn, have facilitated intraregional, intra-industry and intra-firm trade (ESCAP, 2015). Efficiency-seeking FDI increases the amount of trade taking place within the international production networks of MNEs.

The global, regional and national regulatory framework for trade have also had implications for investment. At the global level, the multilateral trading

system under 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 example, the Agreement on Trade-Related Investment Measures (TRIMS) contains various provisions that prohibit performance requirements on foreign investors that 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, although a working group under WTO analysed the interlinkages of FDI and trade. Since 2020, negotiations on an investment facilitation for development agreement have been underway at the WTO among 110 members. The purpose of these discussions has been to develop a multilateral framework on investment facilitation for development, focused on “improving the transparency and predictability of investment measures and reducing ‘red tape’ costs associated with administrative procedures and requirement” (Berger A key reason that discussions have progressed under this round compared to previous rounds has been due to exclusions of several issues from the discussions, including market access, investment protection and Investor-State Dispute Settlement.

At the regional level, the proliferation of regional integration arrangements (RIAs) or regional trade agreements (RTAs) alongside the multilateral trading system, is noteworthy.<sup>11</sup> 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,<sup>12</sup> common markets, economic unions, economic partnership agreements etc. Recently, RIAs have tended to be broad-based economic partnership agreements with commitments on services, intellectual property rights, investment, competition policy, environment and other economic areas.

In addition, ambitious “mega-regional” agreements, which include investment provisions, have been

<sup>10</sup> 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](http://www.standrews.ac.uk/business/distance/Economics/Reading/Critique_trade_theories.pdf)

<sup>11</sup> 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).

<sup>12</sup> A customs union is a free trade area with free trade or relatively low tariffs on trade among the members, 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.



signed, i.e., the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) and Regional Comprehensive Economic Partnership (RCEP) agreements (box 2.2). In addition to such agreements, trade and investment facilitation programmes have simultaneously and actively been incorporated into the work programme of the Asia-Pacific Economic Cooperation (APEC) forum. In 2008, APEC launched an Investment Facilitation Action Plan (IFAD)<sup>13</sup> with eight guiding principles. Among these principles, most notable, and similar to the

discussions currently underway at the WTO, is the focus on enhancing transparency, predictability, stability and efficiency of the investment environments within APEC members. APEC's Investment Expert Group (IEG) has regularly been reviewing the implementation of IFAD and has published several progress reports on its status. As of 2021, IFAD was in its fifth phase of implementation and was reviewing the eight initial principles that it set out to achieve in order to determine whether they are still relevant.<sup>14</sup>



### Box 2.2 Investment provisions in the Regional Comprehensive Economic Partnership (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)

As of the end of 2021, there was a total of 2,593 IIAs in force globally. Of these, 1,528 BITs were in force and 173 BITs under negotiation involving an ESCAP member State. In addition, there were 765 TIPs involving ESCAP member States. Most noteworthy in recent years has been the signing and entering into force of RCEP and the CPTPP.

The RCEP entered into force in January 2022 and comprises 15 countries (Australia, Brunei Darussalam, Cambodia, China, Indonesia, Japan, the Lao People's Democratic Republic, Malaysia, Myanmar, New Zealand, the Philippines, the Republic of Korea, Singapore, Thailand and Viet Nam), it is now the largest trading bloc and covers nearly one-third of the global economy.

Of the 20 chapters of RCEP, chapter 10 outlines the investment provisions according to four key pillars: protection, liberalization, promotion and facilitation. The chapter consolidates existing market access among the Parties as previously contained in numerous bilateral agreements (UNCTAD, 2020d). Included in the chapter are a most-favoured nation treatment clause, commitments on the prohibition of performance requirements that extend beyond the WTO Trade Related Investment Measures Agreement obligations, a schedule of reservations and non-conforming measures that allow for a negative list approach for entry, a framework for supporting efforts to liberalize investment in the future and, finally, several investment facilitation provisions, including aftercare services and assistance complaint and grievance resolution (ASEAN 2020). The chapter does not provide any provisions on investment protection or non-discrimination. More specifically, it does not include investor-state dispute settlement mechanisms. However, RCEP Parties have agreed to review this after five years from when the Agreement has entered into force (New Zealand Ministry of Foreign Affairs and Trade, 2020). Several other chapters in the Agreement also indirectly will affect investment, such as those on trade in goods, trade in services, e-commerce, other rules and disciplines, and economic cooperation.

In comparison, the CPTPP was signed and entered into force for those parties who ratified the Agreement in 2018. Members of the CPTPP include Brunei Darussalam, Malaysia, Singapore and Viet Nam, plus Australia, Canada, Japan, Mexico, New Zealand and Peru. Compared to RCEP, CPTPP in particular aims for stricter common standards on labour rights, environmental protections and investment dispute resolution. The inclusion of the investor-state dispute mechanism in the Agreement is the most noteworthy difference in the investment chapter of CPTPP compared to RCEP (except for New Zealand for which these provisions will not apply).

CPTPP's investment chapter also provides provisions for, *inter alia*, national treatment, most-favoured nation clauses, performance requirements, minimum standards of treatment, expropriation and compensation, and capital transfers. Policy space and flexibility have also been incorporated into the Agreement through reservations referred to as 'non-conforming measures' that allow Parties to the Agreement to maintain exceptions to the CPTPP services and investment chapters in particular (Government of Canada, 2018).

<sup>13</sup> See <https://www.apec.org/Achievements/Group/Committee-on-Trade-and-Investment-2/Investment-Experts-Group-1>

<sup>14</sup> See <https://www.apec.org/Groups/Committee-on-Trade-and-Investment/Investment-Experts-Group>

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. The changing global characteristics of foreign direct investment and MNCs

Both globally and regionally, the characteristics of FDI and MNCs have undergone some changes that policymakers should take note of, in particular:

- **World-wide sourcing/supply chain management.** Together with market-seeking FDI, efficiency-seeking FDI has been an important type of FDI world-wide, particularly in East and South-East Asia. Globalization, and trade and investment liberalization, coupled with ICT developments, have allowed companies to source world-wide for parts and components and other resources as part of the production process. This has given rise to the emergence of GVCs;
- **Global market presence is essential.** Because of the rise of GVCs, for many larger MNEs 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 MNEs 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.** World-wide sourcing and supply chain management are closely linked with cost minimization. As the world has become a battleground for MNEs, competition has been defined by lower costs and higher quality. ICT has played an important role in cost minimization and greater efficiency in production and customer care;
- **Customized end-products.** With increasingly sophisticated demand, MNEs 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;
- **FDI in manufacturing and assembly.** 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, and 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. The ratio between higher and lower skill-intensive activities was approximately five times greater in 1990-1992, and reached approximately 14 times greater in 2005-2007;
- **Intangible assets (brands, skills, innovation) are more important than tangible assets (factories, warehouses, dealer networks).** The most successful MNEs are those that have developed brand name recognition (Quelch, 1999; Holt and others, 2004). People don't buy computers or smart phones. 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 that 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 normally is not sustainable in the long term. Today, even the most recognized brands such as Sony, Nokia and even Microsoft are struggling with emerging competition;
- **Increasing importance of SMEs as MNCs.** This is detailed, for example, by Fujita (1995) and trend analysis reports of fDi markets. With the spread of MNEs world-wide, as noted above, their suppliers often follow them (e.g., the electronics industry in Penang, Malaysia, and the 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 (e.g., Moran and others, 2016), they may also pose competition with SMEs in the host countries 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 versus the potential for crowding out domestic SMEs. Many countries are adopting programmes that will raise the competitiveness of domestic

SMEs in terms of efficiency, technology, compliance with global standards and labour skills, and aim to integrate their domestic SMEs with global or regional value chains;

- **Growing awareness of the role of FDI in supporting the SDGs and an increasing importance of emerging economies as outward investors.** Traditionally, FDI emanated from developed countries such as Europe, Japan and the United States. However, FDI from emerging economies has been on the rise during the past two decades. For example, since 2018, developing countries in Asia and the Pacific have been the largest outward investors globally. The rise of developing countries as key outward investors can have important development implications, both for home and host economies.

FDI is recognized as an important means of implementation of the Sustainable Development Goals. Similar to FDI from developed economies, FDI from developing economies has the potential to facilitate positive developmental outcomes, both in home and host countries – i.e., generate financial earnings, enhance exports, facilitate more domestic investment, transfer know-how, nurture innovation, upgrade industries, improve standards, enhance productivity, facilitate access to resources and tangible assets, generate employment and promote economic growth. These outcomes can help to support several specific SDGs, such as SDG 8 on decent work and economic growth and SDG 9 on industry innovation and infrastructure. However, the extent to which these favourable effects of FDI can help countries support sustainable development in home and host countries is dependent on the context of the investment, such as the type and motive for the investment, the industry of the investment etc. Governments, both in home and host countries, have an important role to play in monitoring and influencing the consequences of FDI. Policy and regulation can promote the positive effects of FDI while also mitigating any negative consequences it can have;

- **The importance of FDI in the digital economy.** The importance of digital MNEs – including Internet platforms, e-commerce and digital

content firms – has been growing rapidly (UNCTAD, 2017), and the COVID-19 pandemic has accelerated the digital transformation. Measures enacted by Governments to contain the pandemic have propelled businesses towards digitalization and the provision of online operations and services as demand has grown. Firms that are more digitally agile have adapted to this new environment most successfully, while those that are not so agile have focused on improving their digital skills and incorporating new digital services into their business models. At the policy level, Governments must begin to focus on building their digital competitiveness and implementing a coherent digital investment policy. The latter would, for example, focus on attracting and promoting FDI in digital infrastructure and digital firms as well as wider digital adoption. In addition, Governments and administrative bodies such as IPAs must focus on more effectively leveraging digital technology to alleviate the administrative burdens and reduce the bureaucratic hurdles through offering more efficient digital services, such as online one-stop facilities. (ESCAP, 2021; ESCAP, 2022)

## 1. Asia-Pacific MNCs and their global presence<sup>15</sup>

The establishment of subsidiaries is an important vehicle for corporate expansion activity and therefore a crucial component of cross-border as well as domestic investment. While there is wide variance in how much value a subsidiary creates for its host country and how many jobs, if any, it might create, the choice of location for legal subsidiaries still tells much about global business patterns and preferences. An analysis of 2,190 of the world's leading MNCs by the Investment Monitor identified 216,898 global subsidiaries.<sup>16</sup>

Of the 2,190 MNCs analysed<sup>17</sup>, over one-third (36.8 per cent) were headquartered in Asia-Pacific. These companies have 41,255 subsidiaries worldwide. In total, MNCs from 17 Asia-Pacific nations were represented in the study. Japan (264) and China<sup>18</sup> (247) had the highest number of MNCs, accounting for almost two-thirds (63 per cent) of all Asia Pacific companies analysed (figure 2.10).

<sup>15</sup> This subsection was written by Glenn Barkle, Chief Economist at Investment Monitor.

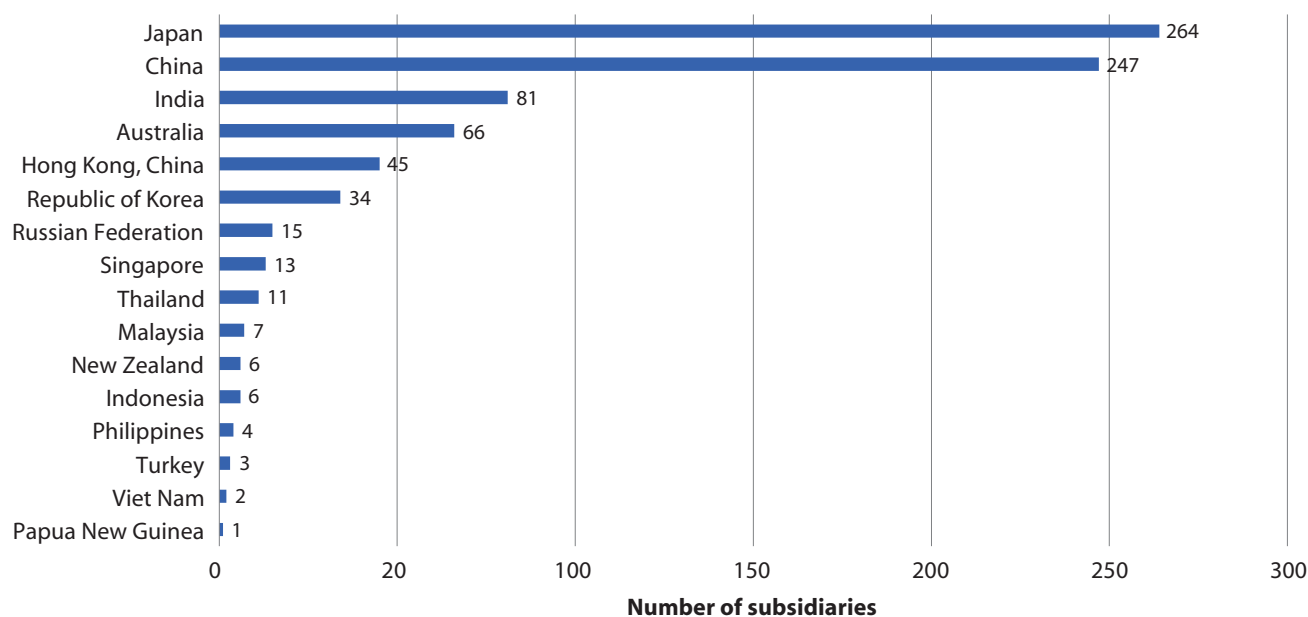
<sup>16</sup> The *Investment Monitor's* multinational companies database analyzes company annual reports, websites and internal databases to reveal MNC subsidiaries where an MNC has more than 50 per cent ownership and/or control. See <https://investmentmonitor.ai/resources/where-are-the-global-hotspots-for-mnc-subsidiaries>.

<sup>17</sup> All analysis in this section is based on the 2,190 MNCs that were analysed for this particular study.

<sup>18</sup> Includes Taiwan Province of China.



**Leading MNCs headquartered in Asia-Pacific, by headquarter country**



Source: Multinational Companies Database, Investment Monitor at [www.investmentmonitor.ai](http://www.investmentmonitor.ai)

Note: Based on 2,190 of the world's leading MNCs.

Table 2.1 shows the number of subsidiaries of leading Asia-Pacific MNCs. Japan had the highest number of MNCs from Asia-Pacific included in the study. These Japanese MNCs have 10,476 global subsidiaries, of which 5,139 are located in Japan (domestic) and 5,337 were created outside of Japan (foreign). Three-quarters (7,818) of the subsidiaries created by Japanese companies were in the Asia-Pacific region (including Japan), with the remainder (2,658 companies) established in the rest of the world (RoW).

Just under four-fifths (78.9 per cent) of subsidiaries created by Chinese MNCs were in China. Only Indonesia (85.3 per cent) has a higher proportion. In total, the 247 Chinese MNCs have established 14,038 subsidiaries worldwide – the most of any Asia-Pacific nation.

Indian MNCs have one of the lowest proportions of domestic subsidiary creation (37.8 per cent). Just over 1,300 subsidiaries were created by Indian MNCs in India, while 2,170 (62.2 per cent) have been created abroad. Singapore and the Republic of Korea MNCs also tended to create more foreign than domestic subsidiaries. This was also true of Hong Kong, China; however, two-thirds of its foreign subsidiaries are based in China.

Intraregional subsidiary creation is very common across Asia and the Pacific. While not unsurprising –

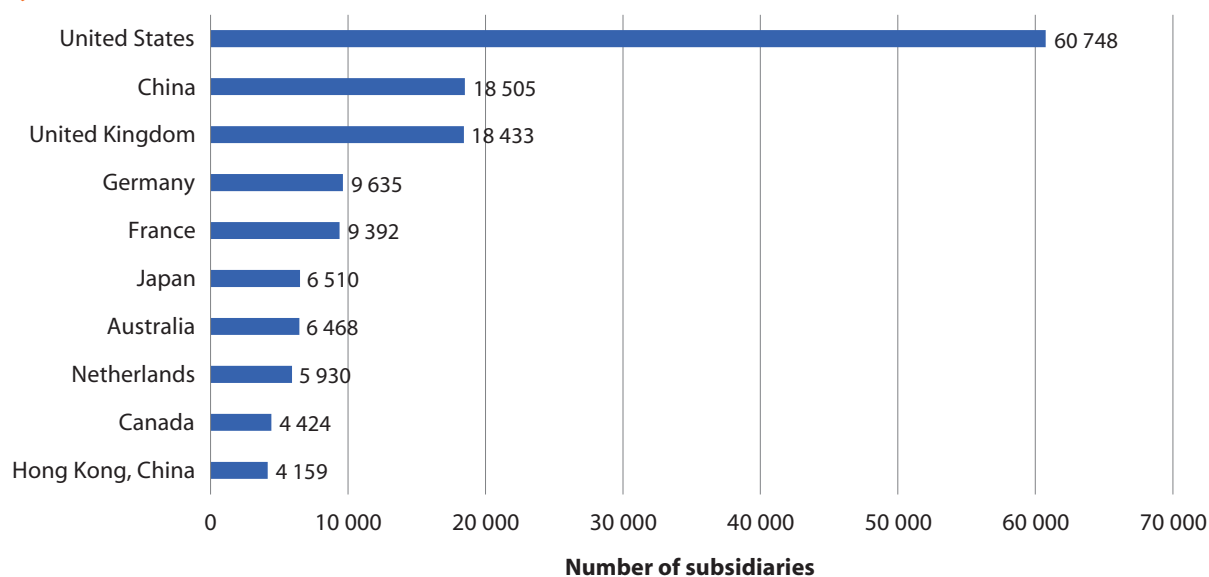
an MNC would perhaps be expected to create a larger presence in its home region than other world regions due to geographic proximity, comparable business environments and similar consumer demand patterns among other factors – the proportions of some Asia-Pacific-based countries are extremely high. For example, the 247 Chinese MNCs have created 14,038 subsidiaries globally, 90 per cent of which are within the Asia-Pacific region. In Indonesia, 96 per cent of the 95 subsidiaries created by its six leading MNCs are within Asia-Pacific, the highest proportion of any country. On average, 78 per cent of subsidiaries were created by MNCs across the 17 Asia-Pacific countries. India had a notably smaller proportion, with only around half (52 per cent) of its MNCs creating subsidiaries in its home region. The United Kingdom, United States, Netherlands and Germany combined were the destination market for one-fifth of Indian MNC subsidiaries.

Globally 216,898 global subsidiaries were identified from the world's leading 2,190 MNCs. Within the top 10 countries, by number of subsidiaries, four Asia-Pacific countries were present. China ranked second, behind only the United States, with leading MNCs creating 18,505 subsidiaries in the world's most populous country (figure 2.11). Japan (6,510 subsidiaries), Australia (6,468) and Hong Kong, China (4,159) were also key markets for the presence of leading MNC subsidiaries.


**Table 2.1** Number of subsidiaries of leading Asia-Pacific MNCs, by country

Country	MNCs	Subsidiaries	Domestic	Foreign	Asia Pacific	Per cent
Japan	264	10 476	5 139	5 337	7 818	2 658
China	247	14 038	11 080	2 958	12 625	1 413
India	81	3 489	1 319	2 170	1 830	1 659
Australia	66	4 351	2 780	1 571	3 243	1 108
Hong Kong, China	45	3 375	1 261	2 114	2 768	607
Republic of Korea	34	2 086	673	1 413	1 430	656
Russian Federation	15	724	518	206	559	165
Singapore	13	791	281	510	513	278
Thailand	11	817	377	440	679	138
Malaysia	7	400	189	211	317	83
Indonesia	6	95	81	14	91	4
New Zealand	6	123	68	55	102	21
Philippines	4	183	110	73	154	29
Turkey	3	133	69	64	90	43
Viet Nam	2	103	74	29	85	18
Macao, China	1	39	10	29	35	4
Papua New Guinea	1	32	15	17	18	14
<b>Total</b>	<b>806</b>	<b>41 255</b>	<b>24 044</b>	<b>17 211</b>	<b>32 357</b>	<b>8 898</b>

Source: Multinational Companies Database, Investment Monitor at [www.investmentmonitor.ai](http://www.investmentmonitor.ai)


**Figure 2.11** Destination location for leading MNCs subsidiaries


Source: Multinational Companies Database, Investment Monitor at [www.investmentmonitor.ai](http://www.investmentmonitor.ai)

Note: Based on 2,190 of the world's leading MNCs,

In total, the 2,190 leading global MNCs have 53,353 subsidiaries in Asia and the Pacific. This equates to one-quarter (24.6 per cent) of the total number of subsidiaries worldwide.

East and North-East Asia accounts for more than half (58 per cent) of all subsidiaries established in the Asia-Pacific region. China, Japan and Hong Kong, China are the key markets within the subregion. More than 30,000 leading MNC subsidiaries are present in the subregion. It should be noted that the majority of

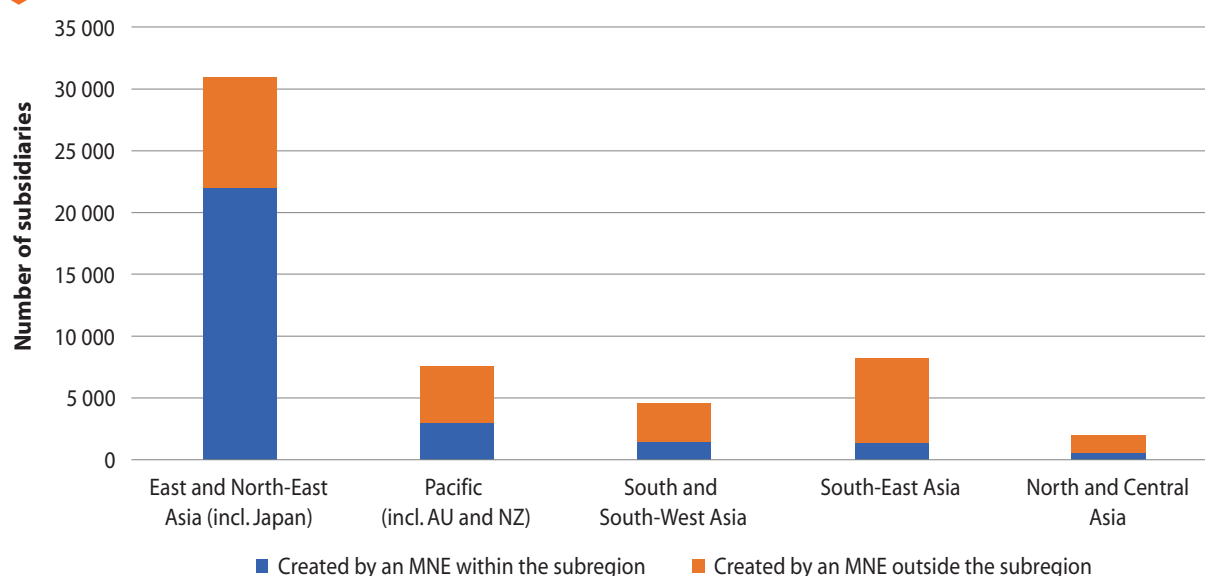
them are domestic subsidiaries. When summing up the total domestic and foreign subsidiaries per country within each of the Asia-Pacific subregions, East and North-East Asia was the only subregion to have more domestic than foreign subsidiaries.<sup>19</sup>

Even when expanding the scope to account for intraregional subsidiary creation,<sup>20</sup> East and North East-Asia was the only subregion to have more 'in region' subsidiaries than 'out of region' subsidiaries (figure 2.12).



Figure 2.12

Subsidiaries of leading global MNCs, by Asia-Pacific subregion, within the intraregional breakdown



Source: Multinational Companies Database, Investment Monitor at [www.investmentmonitor.ai](http://www.investmentmonitor.ai)

Note: Based on 2,190 of the world's leading MNCs.

South-East Asia (8,228 subsidiaries) is the second largest subregion, by number of subsidiaries. Singapore, Malaysia and Thailand account for more than two-thirds (68 per cent) of the subsidiaries in the subregion. Interestingly, each of the 11 countries, included in South-East Asia, had more foreign than domestic subsidiaries. Although this is due to, in some part, a smaller representation in the leading 2,190 MNCs,<sup>21</sup> it also indicates that foreign investors look favourably on the subregion. Investors have often identified the region's large workforce, cost competitiveness and favourable business environment as investment motives. South-East Asia has the largest proportion of subsidiaries created by MNCs outside of the subregion, at 83 per cent.<sup>22</sup>

The Pacific (including Australia and New Zealand) followed closely, with 7,605 subsidiaries. Australia is a key market accounting for two-thirds of the subregion's total. Leading foreign MNCs had slightly more subsidiaries in Australia (3,688) than Australian MNCs (2,780).

Table 2.2 shows the top 10 sources by number of subsidiaries in Asia-Pacific. Six of the top 10 are within the Asia-Pacific region: China, Japan, Australia, Hong Kong, China; India and the Republic of Korea. The four non-Asia-Pacific countries included in the ranking are France, Germany, the United Kingdom and the United States. The United States is the second-largest source market of leading

<sup>19</sup> In East and North-East Asia, 59 per cent of the subsidiaries were established in the same country as the MNC headquarters.

<sup>20</sup> For example, a Chinese company establishing a subsidiary in Japan would be counted as 'in region' as they are both in East and North-East Asia, whereas a Chinese company establishing a subsidiary in Viet Nam would be 'out of region'. Any MNCs not headquartered in, but creating a subsidiary in the Asia-Pacific region would be included as 'out of region'.

<sup>21</sup> A total of 43 MNCs from South-East Asia were included in the 2,190 companies that were analysed.

<sup>22</sup> For reference, the East and North-East Asia ratio was 29 per cent. This was the only subregion with a ratio below 50 per cent.



**Table 2.2** Number of subsidiaries of leading global MNCs in Asia-Pacific by headquarter country (as of 2020)

MNC headquarters	Number of subsidiaries in:					
	Asia-Pacific	East and North-East Asia	Pacific	South and South-West Asia	South-East Asia	North and Central Asia
China	12 625	11 957	162	66	411	29
United States	9 186	3 956	1 784	1 088	1 967	391
Japan	7 818	6 199	325	160	1 093	41
Australia	3 243	123	2 948	24	139	9
United Kingdom	2 930	1 029	711	347	660	183
Hong Kong, China	2 768	2 692	28	6	39	3
Germany	2 256	888	278	387	529	174
France	2 139	903	248	283	528	177
India	1 830	121	90	1 387	205	27
Republic of Korea	1 430	1 113	40	56	193	28
Other	7 128	1 956	991	814	2 464	903
<b>Total</b>	<b>53 353</b>	<b>30 937</b>	<b>7 605</b>	<b>4 618</b>	<b>8 228</b>	<b>1 965</b>

Source: Multinational Companies Database, Investment Monitor at [www.investmentmonitor.ai](http://www.investmentmonitor.ai).

Note: Based on 2,190 of the world's leading MNCs.

MNC subsidiaries in Asia and the Pacific. MNCs from the United States have more than 9,000 subsidiaries across the region. East and North-East Asia is the most popular subregion for American MNCs – 43 per cent of all United States subsidiaries in Asia and the Pacific are in this subregion.

Indeed, for most of the leading non-Asia Pacific headquartered MNCs, East and North-East Asia is the most popular subregion for their subsidiaries. A total of 41 per cent of all subsidiaries created in Asia and the Pacific by United States, United Kingdom, Germany and France-based MNCs are in East and North-East Asia.

South-East Asia is the second-highest subregion by number of operational subsidiaries for MNCs headquartered in the United States, Germany and France. The Pacific is the second-highest subregion for United Kingdom-based MNCs. The strong ties with Australia (and New Zealand) account for this variation.<sup>23</sup>

MNCs from Switzerland, the Netherlands and Ireland are other non-Asia-Pacific based companies that have more than 500 subsidiaries in Asia and the Pacific.<sup>24</sup>

Of the MNCs analysed in the study, 1,717 have at least one subsidiary in the Asia-Pacific region. Table 2.3 shows the top 10 MNCs headquartered outside of Asia and the Pacific, by number of subsidiaries present in that region. LVMH Moët Hennessy Louis Vuitton is the leading foreign MNC in the region. It has 291 subsidiaries and is present across all Asia-Pacific subregions. In fact, the majority of the top 10 foreign MNCs are present across all the Asia-Pacific subregions. Only News Corporation is without a subsidiary in North and Central Asia. East and North-East Asia as well as the Pacific are the most popular subregions based on these top 10 foreign companies. Combined, these MNCs have 691 subsidiaries in East and North-East Asia and 684 subsidiaries in the Pacific subregion.

<sup>23</sup> United States-based MNCs have only 10 per cent more subsidiaries in South-East Asia compared with Pacific. The United States has similar, albeit not quite as strong, ties to Australia and New Zealand as does the United Kingdom (e.g., English language).

<sup>24</sup> Switzerland-based MNCs have 891 subsidiaries in Asia-Pacific, 726 in the Netherlands and 556 in Ireland.



**Table 2.3** Top 10 foreign MNCs, by number of subsidiaries in Asia and the Pacific

MNC	Headquarters	Primary industry	Asia-Pacific subsidiaries
LVMH Moët Hennessy Louis Vuitton	France	Consumer Packaged Goods	291
Siemens	Germany	Power	265
News Corporation	United States	Media	223
Royal Dutch Shell	Netherlands	Energy	218
Linde	United Kingdom	Chemicals	207
Volkswagen	Germany	Automotive	200
Rio Tinto	United Kingdom	Metals and mining	185
Marsh & McLennan Companies	United States	Financial services	180
DXC Technology	United States	Technology and communications	166
Bureau Veritas	France	Business and consumer services	161

Source: Multinational Companies Database, Investment Monitor at [www.investmentmonitor.ai](http://www.investmentmonitor.ai)

Note: Based on 2,190 of the world's leading MNCs.

## C. Impact of FDI on sustainable development in host countries: Economic dimensions

### 1. Introduction

FDI has impacts both on 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 mode, motive and type of FDI,<sup>25</sup> origin of the investor and destination of the investment. For example, the impact of a particular FDI project in one location may be different from the impact of a similar project in another location. Increasing levels of automation and the use of other advanced technologies in investment projects also lead to different impacts, with some being 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: (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 of this chapter is on analysing the impact of FDI on host countries, Chapter 3 addresses the impact of FDI on home countries.

The impact of FDI on the host country is 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) noted, “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 noted 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.

<sup>25</sup> Mode: Greenfield, M&A, joint ventures, strategic alliances, licensing and other partnership agreements. Motive: Resource seeking, market seeking, efficiency seeking, strategic asset/capabilities seeking. Type: Horizontal, vertical, or conglomerate FDI.



Before and just after the Second World War, 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, and capacity of domestic firms are all examples of absorptive capacity factors (see, for example, Nguyen and others, 2009; Farole and Winkler, 2012; Khordagui and Saleh, 2013). A general description of the academic evidence of the impact of FDI on various economic, environmental and social indicators follows below, while recognizing that research is still ongoing with regard to the impact of specific types and forms of FDI.

## 2. Impact on economic growth

In general, ample empirical studies using global, regional and national data panels show a positive impact of FDI on economic growth (e.g., Pegkas, 2015; Abbes and others, 2015; Isıracak and Ulubaşoğlu, 2015; Ferdaous, 2016; Ahmad, Draz and Yang, 2018; Owusu-Nantwi and Erickson, 2019; Ciobanu and others, 2020). However, this correlation might not be naturally similar among countries and even sectors within the economy. For example, Tiwari and Mutascu (2010) also found a positive correlation between FDI and economic growth in Asia, based on panel data analysis; however, they noted that export-led growth is a better option than FDI-led growth. In a study using data of Middle East and North Africa countries, FDI exhibits a positive impact on regional economic growth, although the empirical results for individual countries show a mixed impact of FDI on economic growth (Abdoui and Hammam, 2015). Likewise, Alvarado and others (2017) only found the positive effect of FDI on growth in high-income countries in Latin America; however, FDI showed no impact in the case for upper-middle-income countries and a negative impact on economic growth for lower-middle-income countries. This indeed resonates with a handful of earlier literature. For example, Kosack and Tobin (2006) and Herzer and others (2008) found no significant relationship between FDI and improved economic growth or human development in poor countries. In fact, Herzer and others (2007) found 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 developing countries. Carkovic and Levine (2002) also did not find a robust independent influence of FDI on growth. Within the context of India, Chakraborty and Nunnenkamp (2008) also found that FDI only led to output growth in the manufacturing sector but not in the primary sector.

It follows that the absorptive capacity state of host countries can be a determinant to the magnitude of which FDI can support economic growth (Elboiashi, 2015). In particular, Zhang (2001) found that the impact of FDI on economic growth in the host country is higher in those 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; Gliberman and Shapiro, 2002; Zhao and others, 2003) and political stability (Morrissey and Udomkerdmongkol, 2012). Not only being less likely beneficial, the economy of those countries with relatively low absorptive capacities may suffer from undesirable consequences of FDI flows. For example, Ramzan and others (2019) indicate that if the human capital in host countries is below a certain threshold, FDI becomes detrimental to economic growth. Other than that, 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). A more developed financial system has been found to positively contribute to the process of technological diffusion associated with FDI (Hermes and Lensink, 2003). Azman-Saini and others (2010) also found FDI had a positive impact on growth only after financial market development exceeded a threshold level. A recent study, nonetheless, points out that the development degree of financial markets does not augment the positiveness of FDI on economic growth (Hino, 2018).

In addition, the nature of FDI can be attributable to the FDI-economic growth nexus. Silajdzica and Mehic (2015) suggested that the positive impact of FDI on economic growth is associated with more knowledge-capability and efficiency-seeking FDI. Evidence from South Asia also suggests that FDI in the secondary sector has a significant adverse impact on economic growth, despite the overall positive effect of overall FDI (Chaudhury and others, 2020). There may also be differences in impact whether FDI is in the form of greenfield investment or cross-border M&As (box 2.3).



### 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.

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 by companies with lower technological capability as a way of 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.

The academic literature finds that greenfield and M&As may both result in economic growth under various conditions. For example, Wang and Wong (2009) found that M&As only lead to economic growth if the host country has an adequate level of human capital. Lall (2002) took an overall positive view of M&As, although he noted that: “Transnational Corporations (MNC) 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 MNCs 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 noted that M&As were not normally a feasible form of FDI in less and least developed countries where there is little interest to acquire foreign investors although, in countries with economies in transition, selected state-owned enterprises (SOEs) open to privatization might 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 from 2003 to 2011, Ashraf and others (2014) found 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.

Despite substantial productivity gain associated with foreign ownership, it should be emphasized that greenfield FDI implies the creation of new productive entities and the expansion of capital stock in the host countries, while M&As are fundamentally ownership transference of existing firms. This may result in the minor contribution of M&A sales to the GDP in comparison to greenfield FDI. An empirical study conducted by Harms and Méon (2018) advocated this hypothesis. After testing various estimation methods and subsamples with a data panel of up to 127 industrialized, emerging, and developing countries from 1990 to 2010, the result shows that M&As have a weaker effect on growth than greenfield FDI. In most specifications and samples, the growth effect of M&As is indeed statistically insignificant, whereas greenfield FDI significantly and positively affect the host country’ growth and, to certain extent, its influence is higher when excluding high income countries. The notion of this clashes with the argument of Ashraf and others (2014) on the capability of developing countries to capitalize upon greenfield FDI as mentioned above.

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

*Source:* References in text.

Given the complex landscape that affects the impact of FDI 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 industries 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 in which to invest, leading to an increase both in 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 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, there is no denying that countries with emerging economies such as China and most ASEAN countries, among others, have benefited enormously from FDI.

What is clear is that in today's globalized world characterized by FDI dominated GVCs it is difficult to see how countries can develop rapidly without economic openness that 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 solution for development; it needs to be embedded in a wider policy framework.

### 3. Impact on capital flows and stock and tax revenue

FDI is considered an important source of external capital and financing for development and, as such, has 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):

- The gap between domestic savings and investment (i.e., savings are insufficient to meet investment demand);
- The 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);
- The 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, during 2004-2014, FDI stock tripled in LDCs and Small Island Developing States (SIDS) and quadrupled in landlocked developing countries. This acceleration of FDI can nonetheless 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). Neither the crowding-in nor crowding-out effect of FDI is robustly supported by contemporary literature as empirical evidence is mixed. For example, with the same dataset, Morrissey and Udomkerdmonkol (2012) found that FDI inflows crowd out domestic investment, which contradicts the finding of Farla and others (2016). In the case of China, Chen and others (2017) detected a neutral relationship between FDI and domestic investment. Their research also specified that equity-joint ventures helped to boost domestic investment, which is not the case with fully foreign-funded enterprises.

It appears that the impact of FDI on the domestic capital formation can be contingent upon other factors. These can be how FDI is measured (Herrera-Echeverri and others, 2020), the time horizon in which the impact is captured – whether in the short term or over the long term (Singh, 2017; Tung, 2019; Oualy, 2019), the entry mode of foreign investors (Chen and others, 2017; Cristina, 2018) as well as the sector in which FDI flows to and the technological distance between home and host countries (Amighini and others, 2017). In Viet Nam, for example, FDI exhibits the potential to bring in private investment both in the short and long term (Tung, 2019), which is in accordance with the conclusion of Tung and Thang (2020) when analysing a data panel of 17 developing countries in Asia. By differentiating greenfield FDI and cross-border FDI in the form of M&As in Viet Nam, Nguyen and others (2020) pointed out that while the

former complements domestic investment, the latter indeed exerts a crowding-out effect and consequently hampers the economy not only in the short term but also in the long term. The implication of this finding is in alignment with UNCTAD's recommendation that FDI is a critical source of finance for developing countries; however, policymakers need to give due regard to minimizing risks and adopting policies that make FDI work for development.

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 a crisis. Mallampally and Sauvart (1999) noted 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' annual Financing for Development Forum.<sup>26</sup> The contribution of export earnings to the balance of payments is only mitigated by the import content of production of MNCs 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. International legal provisions as contained, for example 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 anyway to favour high-tax host countries 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. In fact, recent empirical studies have claimed the positive impact of FDI inflows on tax revenue (Aslam, 2015; Odabas, 2016; Bayar and Ozturk, 2018). However, there is still evidence indicating no effect or even a negative impact of FDI on aggregate tax revenues (Jeza and others, 2016; Bayar and Ozturk, 2018).

Furthermore, the correlation of FDI with tax revenue seems more sophisticated with multiple facets to be examined. Using the panel data that cover up to 80 developing countries, Pratomo (2020) found that FDI net inflow positively affects total tax revenue, corporate tax revenue, individual tax revenue, and VAT revenue although, overall, the real effect of FDI on tax revenue is relatively modest. With reference to the host country's economic development, and when detaching the contribution of brownfield and greenfield FDI to government revenue, he established that brownfield FDI tended to erode tax revenue in developing countries but helped higher income countries elevate their tax revenue. Greenfield FDI on the other hand, is generally beneficial to the host country's tax income, although the effect declines as the country moves up the economic ladder. Taking a sectoral perspective, Balıkcıoğlu and others (2016) shed light on the quality effects of FDI on taxes paid by Turkish manufacturing firms; that is, the higher the level of technology base within foreign-owned firms, the more significant the impact of FDI on taxation.

On the negative side, MNCs are known to reduce their tax burden by registering their parent company in tax havens and engaging in transfer pricing (box 2.4). This leads to so-called "base erosion and profit shifting", which refers to the negative effects of MNCs' tax avoidance strategies on national tax bases. However, Dharmapala (2009) argued that "recent evidence suggests that tax havens tend to have stronger governance institutions than comparable non-haven countries," and, as a result, in some cases can actually boost efficiency and reduce tax competition.

<sup>26</sup> See <https://www.un.org/development/desa/financing/what-we-do/ECOSOC/financing-development-forum/FFD-forum-home> for more on the Financing for Development Forums and their outcomes.



## MNCs, tax havens and transfer pricing

Tax havens allow MNCs to shift profits out of high tax jurisdictions into low tax jurisdictions most commonly via transfer pricing (Eden, 2009). Transfer pricing is the pricing of cross-border intra-firm transactions between related parties that 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 in which the MNC is doing business. Transfer pricing is a well-known tactic used by MNCs to avoid or evade taxes or at least minimize the tax burden. In addition, MNCs 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 by Egger, Eggert and Winner (2010), have confirmed that MNCs pay little tax relative to their profits. Focusing on United States MNCs only, Garcia-Bernando and others (2021) identified a misalignment of high profit relative to real economic activity of MNCs in countries with low effective tax rates, which corresponds to profit-shifting practices.

This conflicts with the MNC as a good corporate citizen and the need to implement responsible business practices. In a global economy where MNCs play a prominent role, Governments need to ensure that the taxable profits of MNCs are not artificially shifted out of their jurisdiction, and that the tax base reported by MNCs in their home country reflects the economic activity undertaken therein. For MNCs, 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.<sup>27</sup> 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.

In response, OECD’s Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations<sup>28</sup> 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 undergone revisions, most recently in 2017. The OECD also published an Action Plan in 2013 to tackle corporate tax avoidance with recommendations to tackle corporate tax avoidance, but these recommendations are not binding.<sup>29</sup> 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.<sup>30</sup> 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.<sup>31</sup> These actions finally culminated with the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting,<sup>32</sup> which was ratified by 95 countries and jurisdictions on 18 February 2021.<sup>33</sup>

While adopting these actions and strengthening anti-avoidance rules appear to benefit host countries with short-term gains, the introduction of these measures may result in rather complex and unexpected implications. Mooij and Liu (2018), for example, found a negative impact of tightening transfer pricing regulations on MNCs’ investment in local affiliates. MNCs’ global investment, however, remain relatively stable, thus suggesting a tendency of redirecting investment to affiliates in other countries. Reinforcing national regulations on transfer pricing could inadvertently create impediments to cross-border acquisitions (Mescall and Klassen, 2015, cited in Padhi, 2019). Regarding other anti-avoidance efforts, Buettner and others (2017) pointed out the adverse effect of thin-capitalization rules on FDI in high-tax countries. Such effect on FDI is not the case when stricter transfer pricing regulations are imposed. It is imperative to have more empirical evidence to inform policymakers, particularly in developing countries for which base erosion, profit-shifting and international tax competition are of great concern (Crivelli and others, 2015; Johannessen and others, 2017, cited in Beer and others, 2018).

Source: OECD and references quoted in text

<sup>27</sup> 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.

<sup>28</sup> Available at <http://www.oecd.org/ctp/transfer-pricing/transfer-pricing-guidelines.htm>

<sup>29</sup> Available at <http://www.oecd.org/ctp/BEPSActionPlan.pdf>

<sup>30</sup> Available from <http://www.oecd.org/tax/g20-finance-ministers-endorse-reforms-to-the-international-tax-system-for-curbing-avoidance-by-multinational-enterprises.htm>.

<sup>31</sup> Details of each action can be accessed at: <http://www.oecd.org/ctp/beps-actions.htm>.

<sup>32</sup> The text of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting can be accessed at <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>.

<sup>33</sup> The list of signatories and parties can be accessed at: <https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf>.

#### 4. Impact on employment, wages and skills

Overall, the continuous inflow of net FDI is a good source of employment in developing economies (Onanuga and Onanuga, 2018). The impact of FDI on employment is clear in the area of labour-intensive industries exploiting low-cost labour (Nguyen and Dinh, 2015); generally, greenfield investment is more likely to result in employment generation than M&As as the latter could result in consolidating the new firm, which could lead to cost-cutting and dismissals. It is also noted that brownfield investments expand employment at a rate more than double that of similar domestic firms (Ragoussis, 2020). Indirectly, FDI may increase the employment levels in local firms through forward and backward linkages in domestic production, although FDI also may crowd out inefficient domestic firms leading to loss of employment (Nguyen and Dinh, 2015).

In assessing the employment effect of FDI in India, Someshu (2015) distinguished the following possible impacts:

- **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 example, in the form of joint ventures or vertical linkages that 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 it is a positive impact (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; Irpan and others, 2016, for the case of Malaysia; Wall and others, 2018, for the case of Africa; Saucedo and others, 2020, for the case of Mexico) although some other researchers have found no impact (e.g., Sitompul and others, 2019, for the case of Indonesia; Nordin, 2017, for the case of Malaysia; Mishra and others, 2020, for the case of India). Indeed, the impact of FDI on

employment is sometimes not evident and can depend on many factors. For example, in India, FDI has a significant positive effect on employment of workers who receive some sort of contract of employment, but it has no effect on short-term workers hired on a casual basis (Gupta, 2020). FDI can also have a negative impact on employment. Indirect employment effects have been minimal and possibly even negative because of the limited linkages that foreign investors create as well as the possibility of crowding out of domestic investment due to induced competitive pressure (e.g., Jenkins, 2006, for the case of Viet Nam). Moreover, with ongoing automation, labour-saving technology and use of robots in production processes, the contribution of FDI to employment may further decline (Jude and Silaghi, 2015, for the case of Central and Eastern Europe). Table 2.4 summarizes the potential direct and indirect effects of FDI on employment.

Although there is solid literature on the impact of FDI on employment in general, empirical studies of the effects on the employment of women remain relatively limited. Helble and Takeda (2020) found no evidence that FDI in Cambodia helps to reduce the gender gap either in the ready-made garment (RGM) sector or in manufacturing sectors. Nonetheless, the impact of FDI on women's employment has been particularly impressive in some sectors in other countries such as the RMG industry in Bangladesh (Fernandes and Kee, 2020); it was found that in this particular case, not only did MNCs hire more women, but that these practices had positive ripple effects up and down supply chain linkages. Thus, FDI presence may provide more jobs for women and lead to gender empowerment. Other scholars showed that foreign affiliates in Viet Nam create more employment opportunities for female workers than domestic firms. However, most of these jobs are in low-skilled occupations whereas job opportunities for high-skill female workers created by foreign firms are limited, likely due to Viet Nam's comparative advantage in labour-intensive low-tech manufacturing (Coniglio and others, 2017). In Japan, foreign affiliates are more gender-equal in the sense that they exhibit higher proportions of females among workers, managers, directors and board members than in domestic firms of comparable size operating in the same industry in the same year (Kodama and others, 2018).

With regard to wages, there is solid consensus that jobs created through FDI firms are associated with higher wages, more stability and training than jobs in domestic firms, especially in developing countries (Javorcik, 2015; Girma and others, 2015; Earle and others, 2018). Both in developing and in developed



**Potential direct and indirect effects of inward FDI on host country employment conditions and evidence per region/country**

	Direct		Indirect	
	Positive	Negative	Positive	Negative
<b>Quantity</b>	<p>Foreign ownership increases employment in affiliate firms, especially in the area of labour-intensive industries.</p> <p>Greenfield and brownfield investments also expand employment.</p> <p>FDI positive impact on job creation in <b>China</b> (Fu and Balasubramanyam, 2005), <b>Fiji</b> (Jayaraman and Singh, 2007), <b>Malaysia</b> (Pinn and others, 2011; Irpan and others, 2016), <b>India</b> (Someshu, 2015), <b>Africa</b> (Wall and others, 2018), <b>Mexico</b> (Saucedo and others, 2020).</p>	<p>Acquisitions may result in rationalization and job losses.</p> <p>In <b>India</b>, foreign enterprises may bring their own workforce as domestic workers do not have the required skills (Someshu, 2015).</p>	<p>Create jobs through forward and backward linkages and multipliers effects in the local economy.</p> <p><b>Indian</b> joint ventures or vertical linkages between foreign and domestic companies may lead to additional employment (Someshu, 2015).</p>	<p>Reliance on imports or displacement of existing firms result in job losses.</p> <p>Introduction of labour-saving technology, automation and use of robots in production processes led to job losses, e.g., <b>Central and Eastern Europe</b> (Jude and Silaghi, 2015).</p> <p>Inefficient and unskilled domestic firms leading to loss of employment, e.g., <b>India</b>, due to increasing competition pressure (Someshu, 2015). Same case in <b>Viet Nam</b> (Jenkins, 2006)</p>
<b>Quality</b>	<p>Pays higher wages, gives more stability and training.</p> <p>Foreign enterprise with strong responsible business sense provides better quality employment.</p> <p>FDI in knowledge-intensive sectors causes the earnings of such workers to be bid up.</p> <p>FDI in <b>Cambodia</b> helps to increase wages and the probability of working in the formal sector (Helble and Takeda, 2020).</p> <p>FDI positive impact on productivity in <b>China</b> (Liu and others., 2000), <b>Viet Nam</b> (Pham, 2008), <b>Indonesia</b> (Sari and others, 2019) and <b>Turkey</b> (Fatima and Khan, 2018).</p> <p>More jobs for women and gender empowerment employment, e.g., <b>Bangladesh</b> (Fernandes and Kee, 2020), <b>Japan</b> (Kodama et al, 2018) or <b>Viet Nam</b> (Coniglio and others, 2017).</p>	<p>Introduces practices in, e.g., hiring and promotion that are considered undesirable.</p>	<p>Spill-over of “best practice” work organization to domestic firms.</p> <p>Inter-sectoral linkages between MNC affiliates and domestic suppliers can be a conduit for productivity enhancement.</p> <p>A national innovation system that encourages cooperation between local research institutions, foreign MNCs and local firms can lead to higher levels of skill development, e.g., <b>Malaysia</b> (OECD-UNIDO, 2019, and Freund and Moran, 2017).</p>	<p>Erodes wage levels and less concerned with working conditions as firms are more focused on international competitiveness (e.g., Rana Plaza in <b>Bangladesh</b> or Foxconn in <b>China</b>).</p> <p>Wage inequalities due to the polarization of skill and employment.</p>

**Table 2.4** (continued)

Location	Direct		Indirect	
	Positive	Negative	Positive	Negative
	Adds new and perhaps better jobs to areas with high levels of unemployment.	Increases 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: ESCAP and quoted references.

countries, FDI leads to higher wages in target firms and industries (Helble and Takeda, 2020; Hale and Xu, 2016), especially in sectors with skill shortages (Becker and others, 2020). Moran (2011) pointed out that foreign firms usually paid 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 similar indigenous firms.

While the traditional presumption has been that MNCs 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 MNC (e.g., a Western country with strong responsible business sense) vs. MNCs from emerging developing countries that are less concerned with working conditions but are focused on international competitiveness. However, Western MNCs have also been associated with substandard working conditions in developing countries (e.g., the RMG industry in Bangladesh<sup>34</sup> and Foxconn in China<sup>35</sup>). OECD (2008a) found a positive wage effect on workers that were directly employed by MNCs, while smaller positive impacts on wages were also found in domestic firms that were part of the supply chain established by MNCs.

With regard to non-pay-related working conditions, the evidence is more mixed. For example, while working conditions in foreign firms tend to differ from those in comparable domestic firms, they do not necessarily improve following a foreign takeover. Furthermore, the growth of FDI might cause drastic changes in the host countries' labour markets. It can be observed that most FDI takes place either in low-tech industries, where wages and skills are low, or in high-tech, where a wage premium is offered for

highly-skilled workers. This mechanism may further polarize high-wage and low-wage employment spectrums, at the expense of middle-skill jobs, and therefore may not have any significant impact on wage inequalities in host countries (Te Velde and Morrissey, 2004). Actually, a level wage gap threshold might exist, below which FDI spillovers are significantly negative, but when the wage gap reaches a high-level threshold, local firms can get benefits from FDI spillovers (Huang and Zhang, 2016).

MNCs often engage in FDI to avoid stringent social and environmental standards in the home country (home-country standard). In some cases, MNCs 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 MNCs 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 MNCs 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 MNCs to improving wages and working conditions in the host country.

With regard to the impact on skills, 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 spill-over 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, for the case of China; Pham, 2008, for the case of Viet Nam; Sari and others, 2019, for the case of Indonesia; Fatima and Khan, 2018, for the case of Turkey; and Hale and Xu, 2016), although the

<sup>34</sup> See, for example, <http://www.cleanclothes.org/resources/publications/2012-11-hazardousworkplaces.pdf> and [http://www.ilo.org/dhaka/Whatwedo/Projects/WCMS\\_240343/lang-en/index.htm](http://www.ilo.org/dhaka/Whatwedo/Projects/WCMS_240343/lang-en/index.htm)

<sup>35</sup> See, for example, <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](https://rdln.files.wordpress.com/2012/01/pun-ngai_chan-jenny_on-foxconn.pdf)



link is not always strong (e.g., Zhang, 2001) and could depend on the type of the FDI. For example, low-skill FDI shifts employment from high- to medium- and low-skill jobs, while skill-intensive FDI generally leads to skill upgrading (Amoroso and others, 2018). 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.<sup>36</sup> Thus, while FDI is often promoted for

improving skills, it is often found that the availability of skills and good local education helps to promote FDI (Noorbakhsh and others, 2001). It follows that LDCs with lower skills and poor infrastructure, poor rule of law and high incidences of corruption, and underdeveloped financial sectors face challenges in attracting and benefiting from FDI (UNCTAD, 2011a). Box 2.5 provides the positive experiences with skills development through FDI in Malaysia.



### Skills development through FDI – the experience of Malaysia

FDI has enabled Malaysia to restructure its skills development profile. The country successfully diversified from exports of raw materials to high-quality manufacturing exports; and within manufacturing, Malaysia was able to shift from low-skilled electronics assembly for export to higher-skilled design and production of sophisticated electronics in GVCs. Malaysia's upskilling success began with the implementation of regional strategies that contributed significantly to the attraction of export-oriented manufacturing FDI. This is particularly the case in the electronics and electrical sector promoted by the State of Penang.

A widely successful initiative by the State of Penang to encourage the skills development of local suppliers has been the Penang Skills Development Centre (PSDC). Established in 1989, the PSDC is an industry-led skills training and education centre in Malaysia. Since its inception, the Centre has grown extraordinarily to become a premium learning institution in the country and is, to this day, recognized as a truly successful example of a regional skills development centre. PSDC initially concentrated on vocational training in electrical engineering and electronics, as part of Malaysia's advance into standardized component production and, subsequently, to higher value-added components and products in the semiconductor, information technology, audio visual, and digital camera sectors. PSDC later added life sciences, biotechnology, pharmaceuticals and medical devices to its repertoire for FDI-SEZ-export expansion.

Since being established, the Centre has trained more than 200,000 participants through more than 10,000 courses, pioneered local industry development initiatives, assisted in the input and formulation of national policies pertaining to human capital development, and contributed directly to the Malaysian workforce transformation initiatives.<sup>37</sup>

Sources: OECD-UNIDO, 2011; and Freund and Moran, 2017.

## 5. Impact on technology transfer, research and development, and industrial upgrading

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 MNCs;
- Employees may leave MNCs 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) claimed that data consistently showed that “foreign investors transfer more 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

<sup>36</sup> See, for example, <http://www.odi.org/sites/odi.org.uk/files/odi-assets/publications-opinion-files/856.pdf>

<sup>37</sup> See, for example, <https://www.psd.org.my/about>.

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, that 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. Technology transfers are often time-constrained by the technological ability of domestic firms and the ownership structure of foreign firms (Malik, 2015). In many cases, the MNC either transfers outdated technology or is discouraged from transferring technology due to inadequate intellectual property rights protection or the inability of local suppliers to absorb and effectively utilize the technology; this leads to MNCs that are more inclined towards imitation of the existing product rather than innovation of a new technology. For that reason, FDI for technology transfer to developing countries and LDCs has been limited (Azman-Saini and others, 2018; Gheribi and others, 2018). On the positive side, with the rise of GVCs, MNCs 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 MNCs 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, foreign ownership and technological spillovers in India show a significant positive effect on domestic firms thanks to their absorptive capacity (Behera, 2016; Ghosh and Roy 2016). Other countries, such as China, have a more ambiguous impact (Lin and others, 2015; Li and others, 2016; Hui and others, 2016). Furthermore, in the specific context of Indonesia, Blalock and Gertler (2008) found that (a) vertical supply chains are a conduit for technology transfer from FDI in emerging markets and lead to productivity enhancement of local firms, and (b) 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 MNCs to source supplies from local suppliers.

The success of horizontal technology transfer through joint ventures depends on the capacity of the local joint venture partner and is also not guaranteed (see chapter 7). Therefore, the transfer of technology

through FDI is not automatic. It requires a favourable investment climate to develop local technological capacity – as demonstrated by the presence of solid education and vocational skills development centres, R&D centres – and a pro-active government policy towards the promotion of learning technical skills to provide 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 noted the important role of Governments. With regard to technology transfer through FDI in ASEAN, they found that Singapore was the most successful. In particular, they noted that, in many instances, it was the speed, efficiency and flexibility of the Government that gave Singapore its competitive edge compared to other competing host countries that were examined. The level of IPR protection also seems to play an important role (see chapter 5). Box 2.6 describes positive experiences of Malaysia and Thailand in technology transfer through FDI.

Many economists consider FDI to be an important channel for the transfer of technology to emerging markets. Nonetheless, the absorptive capacity and domestic innovation capability remain another important asset for host countries in order to maximize the benefits of FDI. As innovation and R&D activities are becoming increasingly important in the region (ASEAN, 2018), it is expected that FDI inflows will increase countries' R&D and innovation activities (Erdal and Göçer, 2015). As a result, domestic innovation capability stems from a knowledge-generation process with well-equipped human resources such as scientists, engineers, technicians, research equipment, and cumulative R&D expenditure (Sivalogathan and others, 2014). Most academic papers find a positive impact of FDI on R&D (Osano and Koine, 2016, for the case of Kenya; Lew and Liu, 2015, for the case of China; Khachoo and Sharma, 2017, for the case of India; and Ghosh and Roy, 2016, for the case of India), while some may find measured impact (Pohit and Biswas, 2016, for the case of India; and Atici Ustalar and Sanlisoy, 2020, for the case of Turkey).

Concerning industrial upgrading, FDI has long been regarded as a key source of new knowledge external to the domestic economy, but relatively little is known about how the technological upgrading of the host regions is affected by industrial structure in terms of considering cognitive proximity. Tang and others (2019) found that in China FDI spillover has a positive effect on local technological upgrading both in nearby and neighbouring cities; and Behera (2016) also found that market concentration is a crucial conduit for the upgrading of firm innovation and technological.



## Technology transfer through FDI – the experiences of Malaysia and Thailand

Malaysia is a good example of successful vertical transfer of technology through FDI. Over the years, the Government of Malaysia has taken numerous actions aimed at digitally transforming the economy and making it the centre of high-tech by 2020. Even though there has not been a specific policy on technology transfer, there has been an emphasis on industrialization and technology development in many of the Government's policies (Hamdan and others, 2018). Since the second half of the twentieth century, the Government of Malaysia has encouraged foreign investors to invest in their industries. It has formulated specific industrial policies to attract MNCs in ever higher technology-intensive industries, bringing with them technology and specialized knowledge and management know-how as well as capital.

Malaysia has managed to attract FDI for decades, even after the global economic crisis in the late 2000s. Since 2010, average annual FDI inflows have been higher than US\$10 billion, and accounted for around 8 per cent of total FDI to ASEAN (cf. most inflows have been into Singapore, amounting to about 55 per cent of total ASEAN FDI) (UNCTAD, 2014; UNCTAD, 2020). 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 upgrading of machinery and product lines, and increased production capabilities of local workers (Lee and Tan, 2006). However, many innovations that are being generated through FDI do not find their way to the market for various reasons (OECD, 2016). Yet, there is potential as Malaysia has been quite successful in tapping the benefits of FDI and technological transfer. The Digital Free Trade Zone (DFTZ) launched in 2017 in partnership with Chinese tech giant Alibaba is a good example of Malaysia's upcoming challenges and opportunities. The Government should promote more local participation where the scope for knowledge and technology transfer is greatest (Todd and Slattery, 2018).

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. During the 1990s, Thailand's industry upgraded from labour-intensive textiles and food processing to skill-based mid-tier manufacturers, particularly in the automobile and electronics sectors, again with Japanese companies as key investors (Mieno, 2013). Since 2000, the automobile industry in Thailand has shifted towards more technology-intensive activities, including engineering (Poon and Sajarattanochoe, 2010). One of the major reasons for this shift was the expansion of Japanese investment in, and technology transfer to Thailand (Techakanont, 2008). Japan also invested in other industries, such as chemicals, paper and metal products as well as machinery (Hartley, 2017). As a result, Japanese investment in Thailand cumulatively totalled US\$85 billion between 1985 and 2016, which represented 43 per cent of total FDI into Thailand (Hartley, 2017). 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 allows 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 as well as developing local technological capabilities. In Thailand, science and technology policies remain rather fragmented (Poon and Sajarattanochoe, 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). Moreover, FDI has stimulated the need for development in local companies. This is part of the reason that encourages the companies in Thailand to continuously develop. Technology is one of the factors that enhance the competitiveness and increase the value of the product. Therefore, companies with their own technology would be more competitive and, therefore, would encourage further technology transfer in Thailand (Rintharawatth, 2018).

*Source:* References quoted in text.

## 6. Conclusions on the economic impact of FDI in host countries

Table 2.5 summarizes the general potential economic benefits and costs for the host country that are associated with FDI.



**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. In LDCs, technology transfer seldom takes place as those countries are most attractive to labour-intensive FDI and presence of a 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 MNCs 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 offset 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.	MNCs may link with domestic SMEs as suppliers raising their capacity and integrating them in global value chains. In the short term, however, issues related to standard compliance and certification and overall competence of local suppliers is a concern. MNCs may attract SMEs as suppliers from their home country that may out-compete the local companies in the host country.
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 MNCs 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.

## D. Impact of FDI on sustainable development in host countries: Social and environmental dimensions

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 example, 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, there is a risk that while FDI may contribute to economic growth, such growth may not be inclusive or create quality jobs. Furthermore, even when FDI contributes to economic growth, the negative externalities of FDI and investment 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).

### 1. Impact on poverty reduction

It is generally understood that FDI contributes directly to poverty alleviation 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. Empirical literature that FDI can have a positive impact on poverty reduction in Asian-Pacific countries (Jalilian and Weiss, 2002; Hung, 2005; Shamim and others, 2014; Ucal, 2014; Uttama, 2015; Agarwal and others, 2017; Trinh, 2017; Ahmad and others, 2019; Khan and others, 2019). Nonetheless, poverty remains an issue in the region and there is certainly scope for making trade and investment more inclusive (ESCAP, 2013).

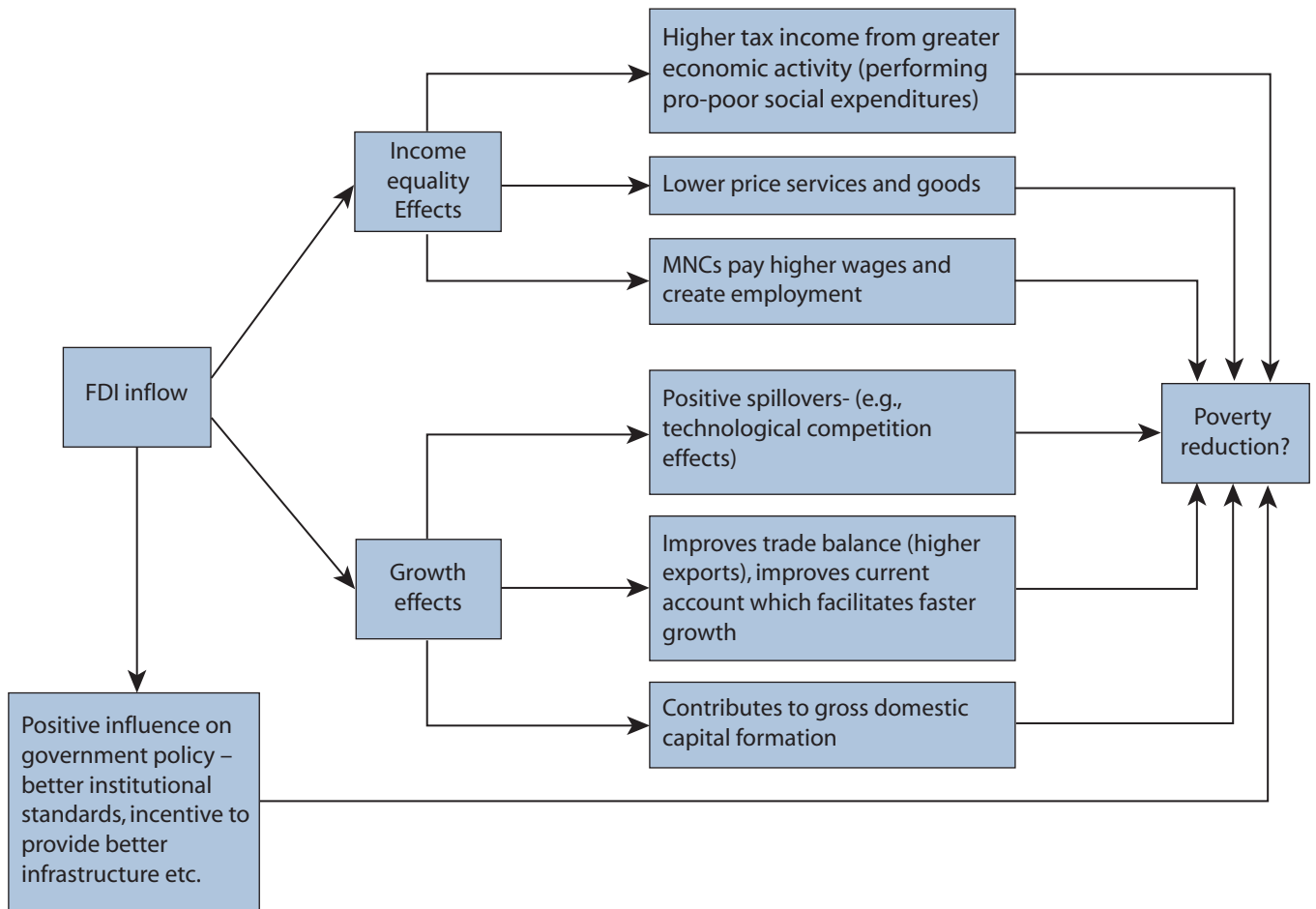
Reports of worker abuse along the supply chains of various MNCs have also raised questions as to the

impact of MNCs 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 MNCs, even though the company producing garments was not a foreign-invested enterprise itself but produced for global brand name MNCs. It could also be argued that it was because of the Government of Bangladesh not enforcing the national building code (The Economist, 2013). As noted above, MNCs generally pay higher wages and offer better working conditions than local companies, but this also depends on the MNC home country. Although FDI is known to contribute to the “growth enhancing” effect, its contribution to the “distribution effect” may not be as apparent. In this regard, various studies have found no direct link between FDI and poverty reduction (e.g., Mold, 2004; Tsai and Huang, 2007, for Taiwan Province of China; Ali and others, 2010, for Pakistan; Gohou and Soumare, 2012, for South and North Africa; and Ogunniyi and Igberi, 2014, for Nigeria). Stiglitz (2002) also pointed out that MNCs often tended 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 international investment agreements. An inevitable consequence of these practices is the possibility that FDI inflows worsen the poor’s welfare as noticed in the case of 12 middle-income countries in East Asia and Latin America (Huang and others, 2010). However, as already noted, there are also positive reports of MNCs 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 MNCs in their operations abroad. Figures 2.13 and 2.14 show two scenarios of possible impacts of FDI on poverty – one scenario highlighting positive effects and one scenario highlighting negative effects. The truth, however, may lie in the middle.



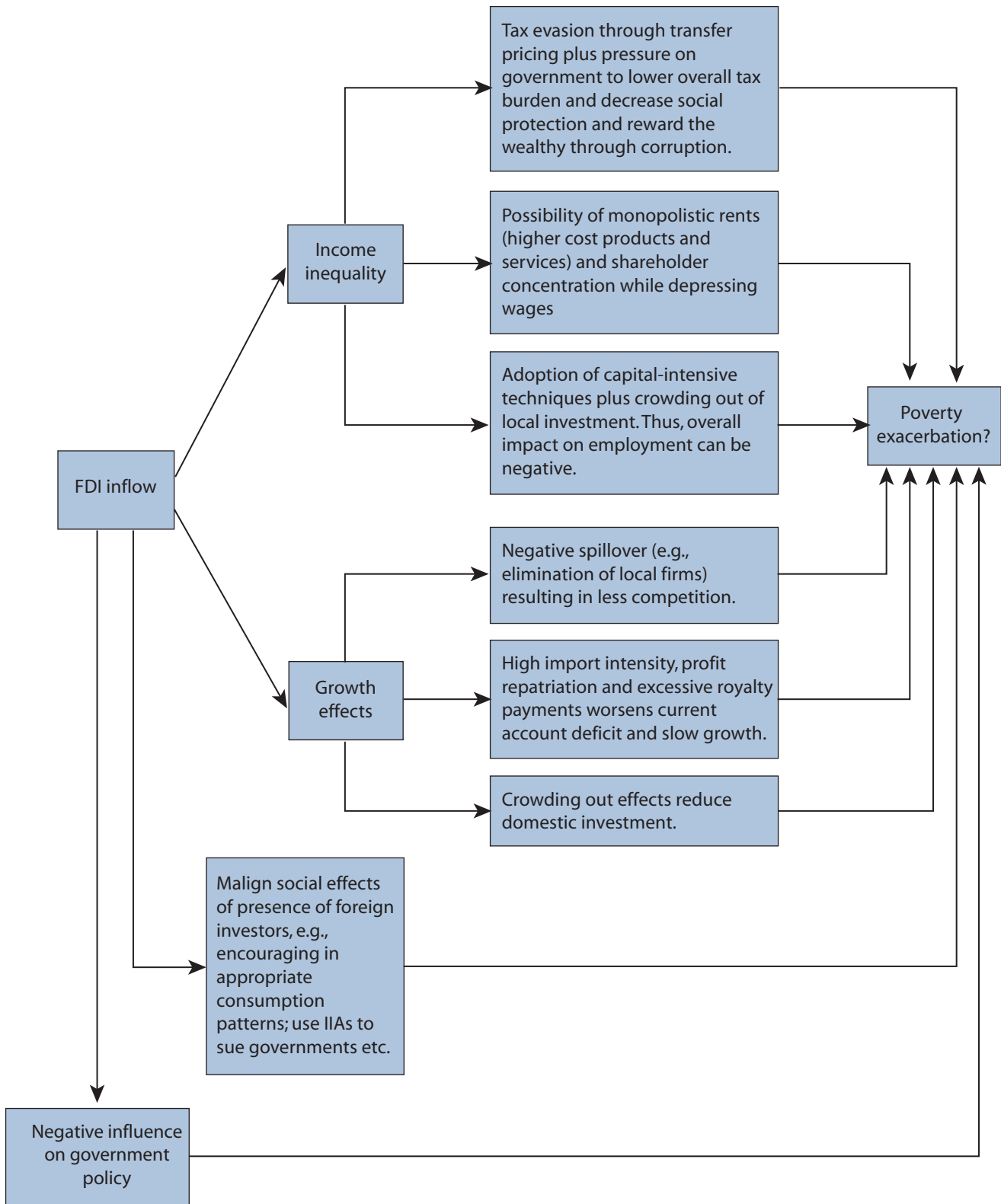
FDI and poverty reduction – positive effects



Source: Mold, 2004.

**Figure 2.14**

**FDI and poverty reduction – negative effects**



Source: Mold, 2004.

## 2. Impact on the environment

The track record of the environmental impacts of FDI is ambiguous. However, the overall perception is that MNCs, 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 extraction sector. Following this conception, the debate on the environmental impacts of FDI has particularly focused on the claim or hypothesis that MNCs 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 evidence for this hypothesis. Their report argued that “the economic growth produced by FDI was 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.” Several empirical studies have also identified the positive correlation between FDI and environmental degradation in Asian countries (e.g., Hitam and Borhan, 2012, for Malaysia; Sun and others, 2017, for China; Behera and Dash, 2017, for South and South-East Asian subregions; Malik and others, 2020, for Pakistan). While these results are critical to forming more environmentally responsive FDI policies, stringent environmental regulations may have a significant and negative effect on FDI, as noted by Zhang and Fu (2008) in their study conducted in China.

Evidence validating the pollution haven hypothesis in the literature is, however, inconclusive. Smarzynska and Wei (2001) found weak evidence for the pollution haven hypothesis, which is consistent with empirical results presented by Nguyen and Le (2018) in the case of Viet Nam as well as Hille and others (2019) in the case of the Republic of Korea. The relationship between FDI and carbon dioxide emissions – the most frequently used pollution indicator (Demena and Afesorgbor, 2020) – has not been evident in some Asian countries and in small island developing states (Gunarto, 2020; Jugurnath and Emrith, 2018). Investigating the FDI-carbon emissions nexus in five ASEAN countries with a sectoral-specific lens, Eriandani and others (2020) did not detect any robust evidence to confirm the existence of this link, except for FDI in pollution-intensive industries, or so-called “dirty sectors”.

At the other end of the spectrum, by introducing more advanced and environmental-friendly technology, together with responsible business conduct and sustainable management experience, MNCs can contribute to the reduction of pollutants of all types, and thus help to improve local environmental conditions. Growing reports in the literature has shone a light on what is called the “pollution halo hypothesis”, which claims the positive effect of FDI on the host countries’ ecosystem. To unveil the FDI-environment nexus ambiguity, Demena and Afesorgbor (2020) conducted a meta-analysis using 65 studies published between 2006-2017. Their findings indicated that the impact of FDI on environmentally damaging emissions (i.e., CO<sub>2</sub>, SO<sub>2</sub>, nitrogen oxides and other volatile organic compounds) is close to zero and, after accounting for heterogeneity, FDI indeed positively influences environmental emissions.

China is an interesting case, with a pronounced number of studies corroborating the pollution halo hypothesis (Liang, 2006; Hao and Liu, 2015; Zhang and Zhou, 2016; Tang and others, 2018; Hao and others, 2020; Yu and others, 2020). Liang (2006) argued that trade and FDI could have a beneficial effect on a developing country’s environment when the MNCs 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. Liang also noted the income effect of FDI – when FDI creates employment and income growth, people might demand a higher environmental standard, more stringent environmental regulation and better enforcement by the Government. Considering the market-oriented reforms in China, Zheng and Sheng (2017) found that the inflow of FDI fundamentally increased CO<sub>2</sub> emissions, but with the transition to a market economy, the increasing effect is reduced. They further explained that as the level of marketization reaches a certain high, FDI will display a decreasing effect on local carbon dioxide emissions.

Cole and others (2006) found that MNCs could have a negative effect on a host country’s environmental regulation, depending on the level of corruption involved, while Hoffmann and others (2005) linked 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, which is probably due to the higher-developed country’s



superior environmental laws and regulations. This appears to be supported by Merican and others (2007) who analysed the impact of FDI on the environment in ASEAN countries. They found that FDI added to pollution in Malaysia, Thailand and the Philippines, but not in Singapore; in Indonesia they found a negative correlation (although presumably they did not cover other environmental issues such as deforestation).

Research by To and others (2019) supports the pollution haven hypothesis in 25 emerging Asian countries but accentuates the inverted U-shape of the impact of FDI on the environment. This means that at the early stage of economic development, FDI degrades the host country's environment, and as the local economy moves up the ladder, such detrimental impact is reversed and FDI becomes beneficial to the environment. Using a cross-national panel of 98 developing countries, Dhrifi and others (2020) found a similar inverted U-shaped relationship between FDI and CO<sub>2</sub> emissions with the Asian sub-panel.

Shahbaz and others (2015) examined the environmental impact of FDI in three groups of high-income, middle-income and low-income countries, and provided a generalized understanding of the pattern of environmental impacts induced by FDI. In particular, FDI is negatively associated with the level of CO<sub>2</sub> emissions in high-income countries, whereas the link is positive in low-income countries, and an inverted U-shaped relationship is found in middle-income countries. It is worth mentioning that the validity of the pollution haven hypothesis does not necessarily eliminate the existence of the pollution halo hypothesis – Liu and others (2018) concluded that FDI has distinct effects on different pollutants, thus confirming the two hypotheses.

On balance, neither the pollution haven hypothesis nor the pollution halo hypothesis is strongly supported by empirical studies, and both can hold true. 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 above, MNCs may bring superior technology and be cleaner overall than domestic companies. It also depends on

whether the MNC's home country is developed and puts strong emphasis on the importance of environmental sustainability as well as holds its companies to account, including in their overseas operations, or whether the home country is an emerging economy that prioritizes economic growth over sustainability.

Lokonon and Mounirou (2019) examined the relationship between inward FDI and the level of deforestation in 35 developing Sub-Saharan countries. The authors provided evidence that increased FDI flows results in more deforestation; however, the extent of this relationship varies significantly between countries. The extent of variation is explained by different environmental policies in the countries studied, with the least protective policies resulting in those countries becoming "pollution havens" (Assa, 2017). On the relationship between biodiversity and FDI, De Santis (2012) and Bhuiyan and others (2018) found that lax environmental policies were associated with a larger loss of biodiversity in host countries due to FDI (De Santis, 2012; Bhuiyan and others, 2018) (see box 2.7). In expanding the pollution haven hypothesis to include political rights and civil liberties variables in a sample of 67 countries, Shandra (2007) found that FDI was more likely to be associated with deforestation when a host country has lower political rights and civil liberties.

Finally, there have also been several studies of the environmental impact of FDI on water supply and quality (box 2.6). Using panel data from OECD and non-OECD countries, Avazalipour (2013) found that a direct relationship between water pollution and FDI existed, with a higher level of water pollution in non-OECD countries through FDI. Polluting industries in non-OECD countries coming from foreign countries via direct investments resulted in higher levels of water pollution (Djokoto, 2012; Jiang and Chen, 2020) associated with FDI in agriculture. This further marginalizes small farmers and results in their closure, which, in turn, decreases food security, and jeopardizes the public health and socio-economic stability of local communities.



### Impact of Coca Cola plants on water access and quality in India

Manufacturing MNCs are large consumers of water and large producers of wastewater. Manufacturing plants can adversely impact the water quality and available water quantity for consumption in local communities (Rudra and others, 2018). The promise of jobs and capital by MNCs makes it difficult for the poor to mobilize and lobby governing officials for water reforms, and Governments have often refrained from regulating MNC water usage in order to prevent them from divesting (Pandya, 2010).

The case of a Coca-Cola plant in the village of Kaladera in Jaipur district of Rajasthan, India, is a prime example of the consequences that FDI can have on water. The Coca-Cola plant was established in 1999 in an industrial park operated by the Rajasthan State Industrial Development and Investment Corporation (RIICO). After several years of operation access to, and the quality of water began to decline for locals in the village. Irrigation costs for farmers increased and led to declining crop and milk yields, and forced them to find alternative ways to obtain drinking water (Karnani, 2012). In 2006, the Energy and Resources Institute (TERI) published a report confirming that the operations of the Coca Cola plant contributed to the worsening water situation and a source of stress to the communities around it (Karnani, 2012).

Rudra and others (2018) analysed the impact of FDI on access to potable water, using subnational panel data from 28 States in India and Union Territories between 1996 and 2009. The study also compared two Coca-Cola plants in two States with similar levels of inward FDI and domestic per capita income albeit with differing demographics. The first Coca-Cola plant analysed was in Kerala, a region with a relative smaller marginalized poor population and a relative larger middle-class population, and the second plant located was in Rajasthan, which had the exact opposite demographic composition. After the Coca-Cola plant opened in the village in Kerala in 2000, the local middle class began mobilizing against the adverse water depletion and pollution effects. Their demands prevailed and after long-running legal disputes between the local government and the company, it ultimately ceased all operations in 2004 (Lambooy, 2011). The Coca-Cola plant in Rajasthan, however, continued operating despite similar observed effects to the local water supply and the mobilization of the local population.

Here the authors provide evidence that the absence of a large middle-class mobilization in the region and the presence of a relatively larger poor population resulted in few actions from the local government and the continuation of the local Coca-Cola plant. These findings emphasize the fact that the estimated results demonstrate that negative water externalities of FDI are mostly borne by the poor in socially stratified and divided states of India (Rudra and others, 2018).

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## Belt and Road Initiative, Chinese FDI and its impact on the environment

China has become a major source of global FDI. Outward FDI from China accelerated from US\$68 billion in 2010 to US\$132 billion in 2020 (UNCTAD, 2021). China's "Belt and Road Initiative" (BRI), an ambitious multi-US\$ billion project towards regional integration, has supported the growth in outward FDI since 2013. The BRI aims to improve trade and transit competitiveness between China, Europe and Africa, and several large infrastructure projects have already been initiated to increase connectivity between those continents. In addition, the Government of China has also openly supported Chinese firms transferring their excess production capacity to other BRI member countries.

The motivations and potential adverse economic, social and environmental consequences of the BRI project have been a topic of hot debate around the globe in recent years. For example, a key concern has been an increased risk of debt in developing countries where Chinese funding and loans are quickly implemented for local projects with little concern for debt sustainability, potentially resulting in 'debt traps' (Rajah and others, 2019; Balding, 2018). The geopolitical motivations for the Government of China to establish and support Chinese soft power in the region have also been of concern (Balding, 2018).

Moreover, considering the magnitude and influence of certain BRI projects, concerns about the development sustainability and the potential adverse environmental consequences in recipient member (and non-member) countries have been raised by several scholars (Kirchherr and others, 2018). These concerns are related to the Pollution Havens Hypothesis, which supposes that the BRI project could take advantage of the economic cooperation between member countries and relocate pollution intensive production and resource-extracting sectors to developing countries in order to increase the share of environmentally-friendly production processes in China. (Liu and Kim, 2018). Such environmental concerns have intensified as China has tightened domestic environmental guidelines, and thereby potentially increased the possible incentives for domestic polluting firms to relocate to developing countries (Liu and others, 2020). In addition, environmentalists have also expressed concern about significant biodiversity losses along BRI trade routes that BRI infrastructure projects will cause as they are developed, because much of the biodiversity areas along these routes are unprotected (Hughes, 2019).

A few studies evaluating the environmental impacts of Chinese outward FDI have recently been released in direct response to the environmental concerns raised above. For example, Xie and Zhang (2020) used data from 21 participating BRI countries to analyse the relationship between Chinese outward FDI through BRI infrastructure projects and the host country's green total factor productivity, a measurement of the level of environmental development. The authors found evidence that China's outward investment has promoted environmentally-friendly production processes and green total factor productivity. Zhou and others (2019) found that Chinese outward FDI related to BRI is associated with increased environmental development in host countries, while research by Liu and others (2020) provides evidence that such investment is increasingly being provided to clean energy projects.

Until more studies emerge that can further confirm these initial research results, it is essential that the negative environmental impacts of future infrastructure projects are limited and that opportunities in areas such as sustainability energy and climate-friendly transport infrastructure are seized (Hughes, 2019; Kirchherr and others, 2018). National planning and decision-making that excludes environmental considerations, unclear business opportunities and difficulty in scaling up sustainability approaches in infrastructure planning have been identified by scholars as the largest obstacles standing in the way (Kirchherr and others, 2018). Therefore, in addition to increasing its own domestic environmental standards, it is essential that China ensures sustainability safeguards are transparently developed with stakeholders and implemented to ensure that BRI-related outward infrastructure FDI is climate- and environmentally-friendly.

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### 3. FDI and the social dimensions of sustainable development: Gender, disability and ageing

The extent to which FDI and MNEs can contribute to key issues related to the social dimensions of sustainable development, such as gender,<sup>38</sup> disabilities and ageing, remain open areas for research. The key findings of recent work in each of these areas is discussed further below.

UNCTAD (2021) has identified several direct and indirect transmission mechanisms through which FDI can affect gender equality. The direct way includes through employment and wages, while FDI can have an indirect impact on gender through spillover effects of supply chains, competition, technology and labour mobility. These mechanisms are further discussed in table 2.6.



**General FDI impact in host countries: Overall and selected gender-related elements**

FDI impact on host countries	Selected gender-related impact
<b>Balance of payments</b> (e.g., related to trade in intermediate and final goods and services, royalties and license fees, reinvestment)	<ul style="list-style-type: none"> <li>Macro-economic impacts on the balance of payments of host economies; examples of FDI-related trade effects include women's employment in export-oriented industries and value chain segments, or in related industries.</li> </ul>
<b>Productivity and market structure</b>	<ul style="list-style-type: none"> <li>Competition effect on local firms (and crowding out or in) impacts women's employment and potential for training and upgrading.</li> </ul>
<b>Labour market</b> (wages, training, labour standards, crowding out or crowding in)	<ul style="list-style-type: none"> <li>Positive and negative impact in terms of direct employment within MNCs, non-equity modalities, or the potential for women's employment in local firms (e.g., micro-enterprises around factories), with an impact on women's wages, training and skills development and overall impact on consumption.</li> <li>Movements of women workers in and out of employment with MNCs.</li> </ul>
<b>Technology transfer</b> (licensing, transfer of know-how, transfer of standards, quality procedures etc.)	<ul style="list-style-type: none"> <li>Potential for new skills development by women employed in MNCs, non-equity modalities, business partners along the value chain, or other local firms.</li> </ul>
<b>Institutional transfer</b> (adoption of formal institutions such as accounting practices as well as informal norms and values)	<ul style="list-style-type: none"> <li>Potential transfer of HR practices related to women's employment.</li> <li>Potential impact of women's employment practices in the rest of the economy (a type of demonstration effect).</li> </ul>
<b>Linkages</b> (effects of MNC activities on local firms such as suppliers or customers)	<ul style="list-style-type: none"> <li>Employment potential for women in local firms that have linkages with MNCs (employment practices on training etc.).</li> <li>Impact on women's employment related to MNC codes on human resources, labour standards and CSR practices.</li> </ul>
<b>Spillovers</b> (effects of MNC activities on unrelated local firms).	<ul style="list-style-type: none"> <li>Impact on women through the transfer of MNC human resources practices in local firms.</li> <li>Potential movement of qualified women employees, increased training for women, or demonstration effects.</li> <li>Institutional adaptation such as adoption by local competitor firms of women-related HR practices used by MNCs.</li> </ul>
<b>Overall impact on economic growth</b>	<ul style="list-style-type: none"> <li>Impact on women through changes in standards of living, consumption, and employment opportunities.</li> </ul>

Source: UNCTAD, 2014.

Table 2.6 clearly shows that much more research is needed in these areas to make a proper assessment of the impact of FDI and MNCs on gender. However, some recent research has made inroads into several areas, albeit with mixed results.

For example, recent evidence has indicated that foreign ownership of firms can prompt changes in the gender-based composition of employees. For example, by analysing data from Japanese firms, including some recently acquired by foreign owners,

<sup>38</sup> This section on gender and FDI draws on report prepared by Soprano (2021) for ESCAP on integrating gender into the trade, investment and innovation work of ESCAP.

Olcott and Oliver (2014) found that the number of female managers rose more sharply in the acquired companies than in the traditional companies over a five-year period. In aggregate, there were five times as many female managers at the acquired companies in 2003 (post-acquisition) compared with 1998 (pre-acquisition). Similarly, Fernandes and Kee (2020) showed that FDI firms in the textile and garment industry in Bangladesh hire significantly more female administrative workers and production workers than domestic firms, even after controlling for firm size, location and industry. It is the same in India, as investigated by Sharma (2020).

In Latin America, available evidence is mixed. In Uruguay, less than half of all firms covered by the Enterprise Survey had female leadership greater than 50 per cent, and only 46 per cent reported having a woman as director or president – yet, the figure rises to almost 60 per cent for both dimensions among foreign-owned firms (UNCTAD, 2021). This is also in line with evidence from Chile (Delgado 2019). In Brazil, on the other hand, research by Davis and Poole (2020) shows that female employment is in fact lower among firms receiving FDI.

Regarding the gender wage gap, evidence is mixed. Research by Kodama and others (2016) on Japanese firms between the 1990s and 2016 suggested that the gender wage gap was smaller in foreign-owned firms. In contrast, as part of their study of Estonian firms from 2006 to 2012, Priit and Masso (2018) found that foreign-owned firms displayed, on average, a substantially higher gender wage gap than domestically-owned firms. Bezuidenhout and others (2019) came to a similar conclusion for South Africa, arguing that, since trading firms require a more flexible workforce, they are able to exploit women's weak bargaining position as they are less likely to unionize. This is in line with standard theory whereby, as multinationals seek places to operate around the globe, they may look for weak standards and low tax rates, which may also translate in poorer working standards for women (the “race to the bottom” examined by Olney, 2013). On the other hand, as documented for Indonesia by Harrison and Scorse (2010), multinationals may also be subject to higher international standards (or else face a backlash from their consumers), which may ultimately lead to them disseminating higher-quality policies and practices to their host countries, including for women. Overall, it is possible that various factors ultimately have an impact on the gendered effects of FDI, including the sector/industry in which investments take place, the type of jobs held by women (re: occupational segregation) as well as the corporate culture of FDI firms, and the gender norms of recipient and investing countries.

Regarding gender policies and practices, evidence suggests that top MNEs tend to be better equipped in terms of gender policies, although their gender practices still show major room for improvement. Based on data collected by UNCTAD on gender policies and practices for the top 100 multinational firms, all 96 with information available reported having a company policy related to diversity, an increase from 95 per cent (five firms) in 2013. In addition, approximately 85 per cent of the top 100 MNEs reported having a policy on flexible working hours, while just over 60 per cent of the top 100 MNE firms provide a day-care service for employees [UNCTAD, forthcoming]. Overall, regular reporting on gender seems to be a well-established habit for MNEs: about 70 per cent of the world's 5,000 largest MNEs regularly report on progress against Sustainable Development Goal 5 on gender equality (UNCTAD, 2020). In terms of practices, on the other hand, UNCTAD found that very few firms report on their gender wage gaps, and that for those the average gap was still at around 70 per cent in 2018 (UNCTAD, forthcoming).

In terms of gendered spillovers of FDI and MNEs to the host economy, available evidence is somewhat encouraging for practices at the country level (but less so for policies). First, a positive and significant relationship can be observed between a country's foreign ownership share and the average share of female owners, even when accounting for industry differences in labour force composition. Second, a similarly positive relationship appears to exist between a country's degree of foreign ownership and its overall female workforce composition, for both non-production workers and production workers. Third, an analysis of the relationship between a country's foreign ownership share and the country's female labour force composition, with focus on domestically-owned firms, supports the idea that positive transmission of female employment opportunities can be triggered with foreign investment, as domestic firms exhibit higher shares of female employment (UNCTAD, forthcoming).

Overall, gendered labour market outcomes appear to be affected mainly by domestic measures rather than by FDI and MNEs, hence policy focus should be primarily on the former. Domestic policies that effectively support equal access to education and training (including in STEM areas) for women and men, incentivize female employment in all industries and occupations, and promote safe and healthy working conditions (including through flexible working hours, adequate maternity/paternity leave provisions, and other measures that support motherhood). This can have a significant impact on labour market outcomes for women. Beyond this, foreign investors



### Promoting gender equality in the investment promotion workflow – the case of the Costa Rica Investment Promotion Agency

Countries have often explored various ways to attract FDI in order to increase economic development in their respective economies. A shift has occurred, however, towards FDI that specifically promotes achieving the SDGs. Five of the 17 SDGs are concerned with the aim to “achieve gender equality and empower all women and girls”. A growing number of IPAs are mainstreaming and promoting gender equality and women’s economic empowerment, both within their agencies and in their efforts to attract, promote and facilitate investment. The Costa Rica Investment Promotion Agency (CINDE) has been globally recognized for its efforts in this regard. CINDE has developed a strategy with concrete indicators that will contribute to enabling Costa Rica to achieve its national commitments on gender equality and women’s economic empowerment (SDG 5).

First, the agency conducted a mapping exercise of all gender supportive initiatives in the country and concluded that many of the initiatives did not measure any impact. In response, CINDE has begun supporting MNCs, particularly in developing impact indicators of their initiatives to support women.

Second, CINDE developed a diversity and inclusion strategy to facilitate more inclusive human resource practices, especially in the hiring processes of companies. For example, CINDE, together with the Costa Rican Institute for Women, has been working to sensitize the MNC employee recruitment practices.

Third, CINDE is actively partnering with NGOs and the private sector to strengthen the local talent pool and create new job opportunities for women. For example, CINDE has worked with a local NGO, called Rocket Girls, to offer free courses for women in science, technology, engineering and mathematics.

Finally, CINDE has committed to improving the availability of sex disaggregated data to better enable the introduction of more tailored policies in support of gender equality and women’s empowerment. As a first step, CINDE has partnered with a local business to gather gender sensitive data on investment sectors. Such data strengthening activities will also contribute to Costa Rica’s ability to meet the Gender Parity Initiative, a global initiative that is aimed at increasing women’s participation in economies, reduce the wage gap and increase women’s representation in leadership positions. As such, CINDE is one of the main agencies involved in implementing the initiative.

*Source:* UNCTAD, 2020. Mainstreaming Gender Equality in Investment Promotion. *The IPA Observer*, November 2020. Available at [https://unctad.org/system/files/official-document/diaepcbinf2020d7\\_en.pdf](https://unctad.org/system/files/official-document/diaepcbinf2020d7_en.pdf)

– especially those from countries with strong gender equality performance – can contribute to promoting gender equality by seeking partnerships with local firms and activating transmission mechanisms, for example, and by offering them training and exchanges on responsible employment practices.

A limited amount of research has been done on the other social dimensions of sustainable development, specifically on ageing populations, migration and health. Regarding ageing populations, an analysis by Narciso (2010) showed the relationship between FDI and an ageing population by drawing on the life cycle hypothesis, which assumes that individuals’ low-risk investment increases with age. He argued that an increase in the ageing population could lower investment demand and increase national savings, leading to higher FDI outflow from “old-aged” developed countries to “young” emerging countries. However, Mitra and Guseva (2021) contradicted Narciso’s findings and in a study of OECD countries showed that an ageing population does not

significantly affect net FDI inflow. In another study, Mitra and Abedin (2020a; 2020b) underscored the fact that any potential adverse effects associated with FDI and ageing populations can be counteracted by public policies.

Regarding migration, Bang and MacDermott (2018) argued that FDI could attract immigration as well as help to narrow the wage gap and reduce emigration. Some studies have highlighted the fact that FDI and migrants can act as substitutes (Kugler and Rapoport, 2007; Tomohara, 2017), and that any potential adverse effects created by increasing emigration from a home country can be somewhat offset by the flow of remittance from them (Javorcik and others, 2011). Tomohara (2017) found that social networks, language and communication skills, and knowledge brought to the host country by immigrants can help to mitigate information asymmetries and transaction cost, boosting FDI to migrants’ countries of origin in the long run (Tomohara, 2017). However, evidence on the extent to which FDI can positively

impact FDI decisions is mixed. Kugler and Rapoport (2007) find that both skilled and non-skilled migrants are beneficial to FDI growth, while Cuadros and others (2019) found that the share of non-skilled migrants is negatively correlated to FDI since FDI-enhancing effect were related to the shift of job skills.

Turning to health, Herzer and Nunnenkamp (2012) found a negative correlation between FDI and health in a study analysing a sample of 14 developed countries. Nagel and others (2015) conducted a panel study of 179 countries, and found that the relationship was non-linear. They also found that FDI positively affects countries with low-income levels, but the effect decreases and ultimately becomes negative as income levels increase. While FDI triggers higher private and public expenditures on social welfare after an initial investment is made in countries with lower income levels, once income levels begin to rise these expenditures are offset by adverse effects to population health that arise because of increased income inequality and competitive pressures.

In conclusion, evidence on the impact of FDI on the social dimensions is mixed. Further quantitative and qualitative case studies are needed to assess the impacts, both positive and negative, that FDI can have on gender, ageing, migration, health as well as any other potential social dimensions (such as disabilities).

## **E. Chapter conclusion: MNCs 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 MNEs and FDI to inclusive and sustainable development is also a responsibility of MNEs themselves. In particular, MNEs 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 MNE lacking responsible business conduct while box 2.13 provides an example of a MNE operating on the basis of responsible business conduct.

Various international bodies have issued standards and principles related to RBC with particular relevance for MNCs. For example, 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.<sup>39</sup>

The OECD Guidelines for Multinational Enterprises provide another good example of a government-backed initiative that aims to promote responsible business conduct.<sup>40</sup> The Guidelines are most widely known for their system of National Contact Points through which disputes between relevant stakeholders with regard to the implementation of the guidelines can be addressed. The United Nations Global Compact principles<sup>41</sup> and Guiding Principles on Business and Human Rights<sup>42</sup> are other examples of international guidelines for responsible business.

It is important to make MNCs and FDI, and business in general, part of the solution to achieve sustainable development, and not merely view them as the problem. ESCAP (2011) argued that MNEs and business in general were 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 turning. For example, the United Nations 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 that 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.

<sup>39</sup> Available at <http://www.ilo.org/global/topics/employment-promotion/multinational-enterprises/lang-en/index.htm>.

<sup>40</sup> Available at <http://MNCguidelines.oecd.org/text>.

<sup>41</sup> Available at <https://www.unglobalcompact.org/what-is-gc/mission/principles>.

<sup>42</sup> Available at <http://business-humanrights.org/en/un-guiding-principles>.

In summary, FDI can have a net positive impact on host countries' economies as well as 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.



### Case study of negative impact of MNCs on host country sustainable development: Asia Pulp and Paper in Indonesia

Asia Pulp and Paper (APP) is an Indonesian MNE 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 MNE engaging in unsustainable business practices, which are a good example of the lack of responsible business conduct prevalent in so many MNEs. 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 had cleared more than 280,000 hectares of rainforest in the past decade, and planned to cut another 300,000 during 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 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; however, these agreements were all terminated due to alleged violations or circumvention by APP. In November 2007, the Forest Stewardship Council (FSC) formally disassociated itself from APP, rescinding the rights of APP to use its logo.

Most recently, and partly as a result of a consistent Greenpeace campaign that 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 fibre 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 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:* <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>; and <http://www.theguardian.com/environment/2014/mar/26/app-deforestation-greenpeace-campaign>





### Case Study of positive FDI impact on sustainable host country development: Unilever Viet Nam

Unilever Viet Nam (UVN) started business in 1995 and was among the first MNEs to establish a subsidiary in Viet Nam. UVN has achieved an average double-digit annual growth and has become one of the most successful foreign investors in Viet Nam. According to the report by the Central Institute for Economic Management (CIEM) (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 lance of payments;
- Linkage with local partners – UVN is a long-term investor and has strong ships 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 the aim to improve their hygiene habits and provide better nutrition;
- UVN has had 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 and Training; women empowerment with Viet Nam’s Women Union; sustainable tea development with the Ministry of Agriculture and Rural Development.

UVN’s significant contribution to Viet Nam provides a positive experience for other MNEs and policymakers. 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). In addition, 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) claimed, 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.

*Sources:* Unilever Viet Nam; references quoted in text.

## F. Discussion questions

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 the most 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 and tax revenue? How does this impact compare with domestic investment?
8. How do you rate your country's absorptive capacity in sectors for benefiting from FDI?
9. What social and environmental impact has FDI had in your country? For example, 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 records on responsible business compare with 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?

## CHAPTER



# Outward FDI and home country development

## A. Introduction

Asia and the Pacific has been the largest source of outward FDI (OFDI) since 2018. Even despite the significant drop in OFDI globally and regionally, Asia and the Pacific nonetheless was responsible for 64 per cent of total global outflows. Perhaps even more significantly, developing countries of the region were the source of 47 per cent of global outflows (ESCAP calculation based on UNCTAD, 2021). The sheer scale of outward investment in the region, and from developing countries in general, raises important questions about the impact that these investment flows can have on helping the home countries in particular achieve the 2030 Agenda and the SDGs. OFDI can be a strategic tool that enables firms to access global markets and integrate into global production systems and value chains, which, in turn, helps firms and industries in home economies to strengthen competitiveness and consequently facilitate better inclusive and sustainable growth opportunities for those economies.

Research and analysis on FDI policies and the activities of MNEs have focused almost entirely on the impact and development implications on the economies of host countries. Home country effects have only been well-documented for developed economies in a limited number of studies (ESCAP, 2017; Knoerich, 2016). Yet, with the growth of OFDI from developing economies during the past 15-20 years, there has been increasing interest in how the home economy of developing countries is affected and to what extent OFDI can contribute to helping them achieve their sustainable development priorities (ESCAP and others, 2021; ESCAP, 2019; Knoerich, 2016).

Inspired by such observations, new theoretical perspectives have emerged to explain the particularities of MNEs from emerging economies. The springboard perspective suggested that MNEs from emerging economies could use OFDI as a “springboard” towards achieving greater competitiveness (Luo and Tung, 2007), while the Linkage, Leverage and Learning (LLL) approach argued that they could upgrade their capabilities by engaging in linking, leveraging and learning activities overseas (Mathews, 2006). New theorization and empirical work have thus increasingly focused on the fact that MNEs pursue assets and advantages when they invest abroad (Knoerich, 2019). It has also been argued that the returns yielded from obtaining such assets and advantages can benefit the home economy and its economic development in various ways (Knoerich, 2017). However, both conceptual and empirical work on home country effects is still at an early stage, with a particular shortage of studies considering the implications of OFDI for sustainable development.

Recognizing this, this chapter is structured as follows. First, OFDI trends are presented, followed by an overview of the mechanisms and channels which link the development effects that OFDI can have with the SDGs in home countries. This is followed by an overview of existing empirical evidence from countries in Asia and the Pacific. Finally, the chapter outlines the home country measures that countries can leverage to harness home country effects, and briefly introduces a menu of options for policymakers to consider in order to maximize OFDI for home country sustainable development.

A more detailed elaboration of the OFDI home country effect, the home country measures as well as the options available to policymakers can be found in the recently released Policy Toolkit for Maximizing OFDI for Home Country Sustainable Development (Knoerich and others, 2021), is available as an interactive online platform at <https://artnet.unescap.org/fdi>.

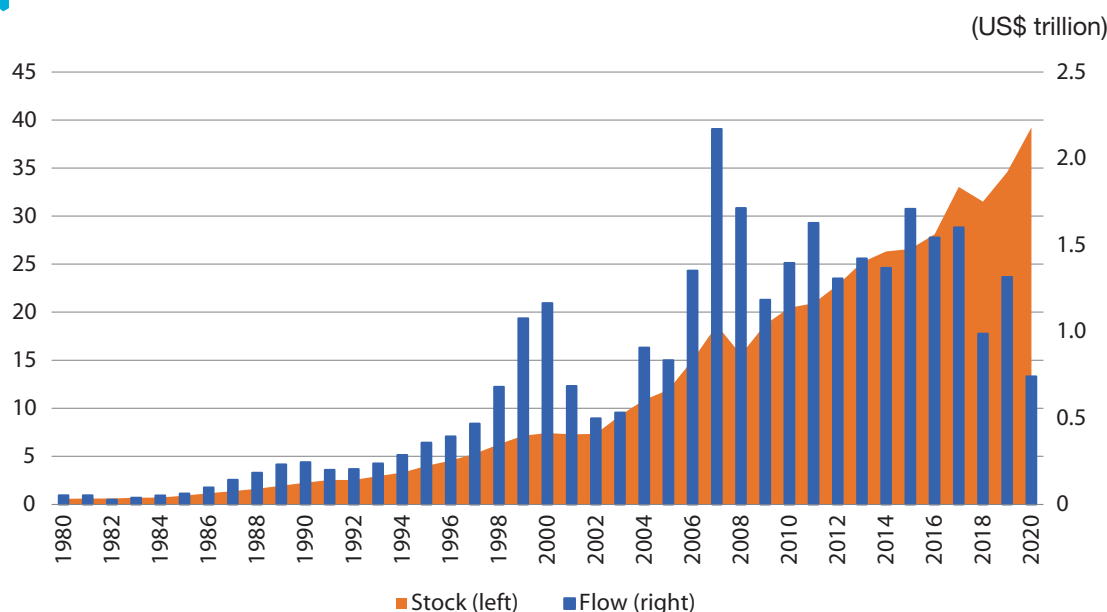
## 1. OFDI trends

As shown in figure 3.1, global OFDI flows have averaged between US\$1 trillion and US\$1.5 trillion annually during the past decade, and OFDI stock (i.e., the historically accumulated value of all OFDI made by the date of the statistic) has accumulated to US\$35 trillion. While OFDI flows are being disrupted due to the Covid-19 pandemic, this is unlikely to undermine the overall importance of cross-border investments. Despite the disruptions, OFDI will continue to be important and will stabilise after the pandemic, and even play a significant role in global efforts of economic recovery (UNCTAD, 2020).

All these cross-border investments not only have an impact in the countries where the investing multinationals operate, but also in the home country at the source of the investment where the multinational is headquartered. Even OFDI made many years ago could still be operational today as it forms part of the accumulated OFDI stock in 2.1. It will thereby still have an impact in the home country and generate home-country effects.



World OFDI, 1980-2020



Source: UNCTADStat.

The growth of OFDI from emerging and developing countries has been especially rapid during the past two decades. While the share of global OFDI flows assumed by developing and transition economies was a mere 8 per cent in 2000, these economies in recent years have accounted for about one-third of global OFDI flows – the figure was 53 per cent in 2019 (figure 3.2).

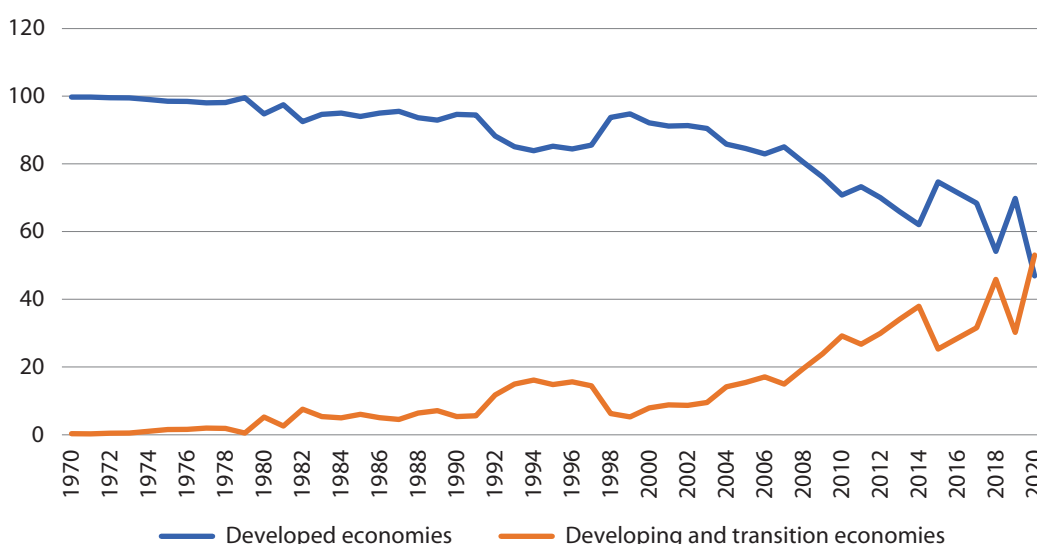
During this period, OFDI stock from developing and transition economies increased from US\$709 billion in 2000 to US\$9.1 trillion in 2020. Annual flows increased from US\$92 billion in 2000 to US\$392

billion in 2020 (figure 3.3). Developing economies in the Asia-Pacific region played an important role in this trend – in 2004, the OFDI stock from this region was just US\$360 billion (excluding Hong Kong, China), but by 2018 this figure had reached almost US\$5.5 trillion (UNCTAD, 2021).

Especially for developing and emerging economies the home-country effects generated from OFDI can be important, as they can contribute in meaningful ways to the economic development of these countries and assist in the realisation of the SDGs (ESCAP, 2020).

**Figure 3.2**

**Share of OFDI flows, by type of economy, 1970-2020**

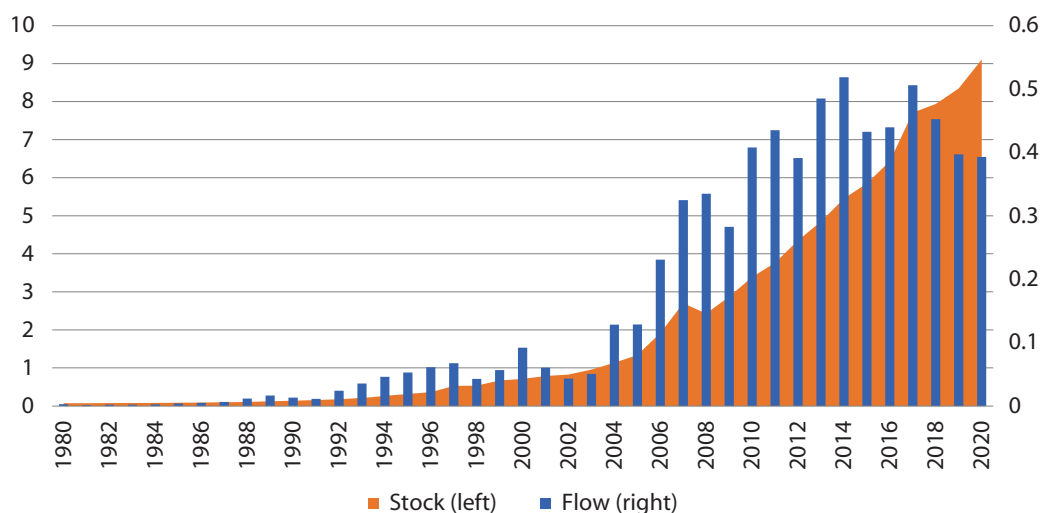


Source: UNCTADStat.

**Figure 3.3**

**OFDI stock and flows from developing and transition economies, 1980-2020**

(United States dollars)



Source: UNCTADStat.

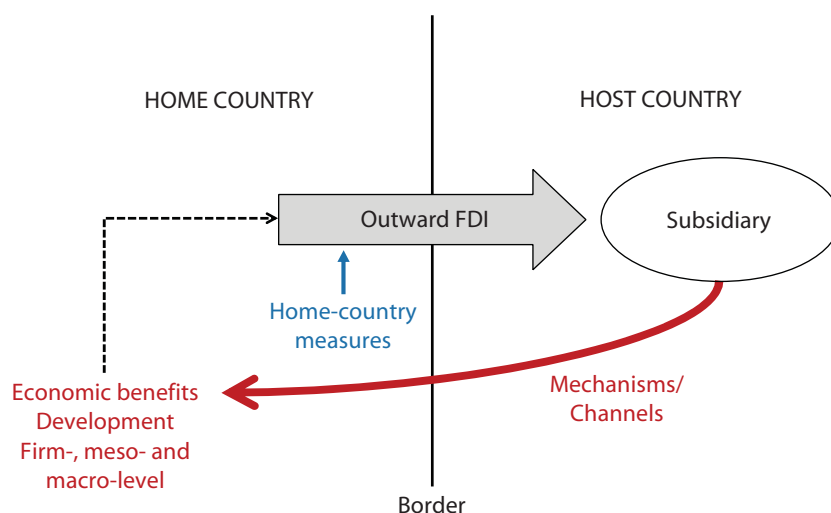
## B. Identifying home country effects and their links to the SDGs

### 1. Different types of home country effects: A conceptual framework

There are several ways to conceptualize how OFDI has effects on economic development in home countries. Figure 3.4 provides a simple illustration –



Home country effects of OFDI: A simple illustration<sup>1</sup>



Source: Knoerich, 2016.

Home country effects go beyond the effects on the MNEs from the home country themselves, such as when they achieve greater competitiveness or technological upgrading from OFDI. Other firms in the home economy – even those without any overseas investments of their own – may also be affected by the international operations of their peers. This may, for example, occur when OFDI by one or a few MNEs results in a general expansion of business and export opportunities for firms in the home economy supplying these MNEs. Finally, the effect may spread to the entire economy and be visible, for example, in greater employment, productivity or economic growth (Knoerich, 2017; Perea and Stephenson, 2018). In other words, there are firm-, meso- and macro-level home country effects.

The economic and sustainable development areas affected by OFDI (such as exports, know-how transfer, industrial upgrading, employment and skills,

as companies establish subsidiaries abroad through OFDI, and pursue assets and advantages in the process, their activities are yielding returns that are transferred to the home economy through a variety of channels or mechanisms. The result can be a beneficial effect on the development of the home economy, yet unfavourable effects may also exist (Knoerich, 2016 and 2017).

financing, competition) are similar to those affected by the operations of MNEs in host economies – however, the direction of the effect is reversed (Stephenson, 2017a). What may differ considerably is the strength of the effect, with home country effects being stronger than host country effects in some areas of the economy, but weaker in others. A useful way to categorize home country effects is to differentiate between financial, intangible and tangible returns. Financial returns are monetary gains for investing firms and their business partners in home economies. Intangible returns result from the acquisition and transfer of know-how and capabilities from host to home countries. Finally, tangible returns are generated from the acquisition overseas and transfer to the home economy of natural resources, capital goods or other tangible assets (Knoerich, 2017). A further distinction can be made between primary effects with an immediate impact and secondary effects that occur as a result of the

<sup>1</sup> Of course, certain host country measures may also affect the extent to which home country effects can occur. For example, any regulations limiting transfer of technology would consequently affect the extent to which effects can be transferred back to the home economy from OFDI.

primary effects. Economic growth could be seen as a tertiary effect, the ultimate outcome of all other effects.

## 2. Linking OFDI home country effects with the Sustainable Development Goals

Given this association between OFDI and economic development, and the existing findings that FDI and the international operations of MNEs have been conducive to achieving the SDGs (UNCTAD, 2014), it is possible to link the SDGs to various home country effects (Stephenson, 2017b). However, in line with the overall literature on investment and development, the SDGs in their original conceptualization have focused primarily on the development implications of investments made in an economy (thus including inward FDI), rather than OFDI specifically. In particular, SDG 17.5 is aimed at countries adopting and implementing investment promotion regimes for least developed countries. Presumably this was meant to reference inward investment, although outward FDI could, in fact, be included in the portfolio of activities to maximize the potential benefits from investment promotion. Thus, it is conceivable that outward FDI plays an important role next to inward FDI, although the link between the SDGs and outward FDI still requires further specification.

Table 3.1 offers an overview of home country effects from OFDI that have been found to exist, that explains the characteristics of each impact and the mechanisms through which they occur. In total, it lists 10 home country effects plus economic growth as a general consequence of all other effects. The SDGs and their targets that are applicable to each home country effect are listed in the final column of the table, which enables a case for the relationship between OFDI and the SDGs to be established. Each of these effects are discussed in further detail below.

First, successful MNEs enjoy financial earnings from profits and revenue generated in their overseas operations, such as market-, efficiency- and resources-seeking investments. While much of these earnings are re-invested in the overseas subsidiaries, substantial proportion tends to be repatriated to home economy headquarters (Knoerich, 2017 and 2018). Once in the home economy, these funds become an additional financial resource that is available for domestic investment or other economic purposes. SDG 17.3 encourages the mobilization of “additional financial resources for developing countries from multiple sources”. The financial returns from OFDI generated by MNEs abroad could be considered as a complementary source of finance next to the remittances generated by people living abroad.

Second, MNEs can enhance exports from the home economy when their overseas operations are trade-creating in nature (Ahmad, Draz and Yang, 2016). This is especially the case when they successfully enter foreign markets, including large ones in developed economies, but also when they continue to supply intermediate products to their factories abroad, including those forming part of global value chains located in other developing countries. Beyond the MNE headquarters experiencing enhanced exports, their suppliers and other firms in the home economy may similarly enjoy associated business opportunities, increasingly exporting to developed economies and supplying global value chains. Accordingly, OFDI has been associated with boosting domestic industrial output and sales (Cozza, Rabellotti and Sanfilippo, 2015; Herzer, 2008, 2011a). While the initial economic gain is in the form of export earnings and more domestic output, in the medium- to long-term large-scale exports and production increases have the potential to facilitate broader industrialization (SDG 9.2). For this reason, finding ways to increase exports is important for developing countries (SDG 17.11).

Third, these various forms of financial earnings, and the improved economic conditions resulting from these and other home country effects, increase the availability of financial resources for domestic investment (Ali and others, 2019; Herzer and Schrooten, 2008). MNEs with successful overseas businesses are also more able to bear the risks of further investments in their home economy operations. It is also plausible that OFDI might result in more inward FDI, e.g., due to cross-border specialization within value chains and greater regional cooperation. Such investments within the home economy over time promote domestic economic activity and industrialization (SDG 9.2).

Fourth, OFDI facilitates access to foreign technological, managerial, marketing and other know-how, and enables MNEs to engage in innovation and technology development overseas, especially in developed economies. This improves the firm-specific capabilities of MNEs. Through the establishment of R&D centres abroad, MNEs tap into local research clusters and available talent with the aim of generating new knowledge and patents. Another option is to acquire or merge with a foreign company in order to gain direct access to its proprietary knowledge. Although greenfield investments may not aim as much for the acquisition or generation of knowledge, they too can benefit from exposure to foreign know-how and reverse spill-over effects in overseas locations, especially in developed economies. Acquired know-how can be used in an MNE's overseas operations and it can be transferred back to the home country, thereby improving the



**Potential positive home country effects of OFDI and the applicable SDGs and targets**

Home country effect	Foreign pursuit	Channels	Type	Level	Sequence	Applicable SDGs and targets
Increased financial earnings	Profits overseas	Repatriated earnings	Financial	Firm	Primary	17.3 (mobilize additional financial resources)
Higher export earnings and more domestic output	Foreign market access	Export opportunities for home country firms	Financial	Meso	Secondary	17.11 (increase the exports of developing countries), 9.2 (promote inclusive and sustainable industrialization)
Larger domestic investment	Consequence of financial earnings and improved economic conditions		Financial	Macro	Secondary	9.2 (promote inclusive and sustainable industrialization)
Increased know-how, innovation, no. of patents	R&D, direct know-how acquisition and reverse spillovers	Know-how transfer and subsequent domestic spillovers	Intangible	Firm	Primary	9.5/9.B (upgrade the technological capabilities, support domestic technology development), 8.2 (achieve higher levels of economic productivity), 7.A (facilitate access to clean energy research and technology), 12.A (strengthen scientific and technological capacity), 17.16 (mobilize and share knowledge, expertise, technology and financial resources)
Improved standards and practices	Adoption from abroad	Implemented at home	Intangible	Firm	Primary	12.6 (encourage companies to adopt sustainable practices)
Industrial upgrading	Greater competitiveness, efficient use of labour force	Skills upgrade, international competition	Intangible	Meso	Secondary	9.5/9.B (upgrade the technological capabilities, support domestic technology development), 8.2 (achieve higher levels of economic productivity), 7.B (upgrade technology for supplying modern and sustainable energy services), 12.A (strengthen scientific and technological capacity)
	Consequence of increased know-how, innovation, patents and capital goods					
Productivity growth	Consequence of all intangible returns		Intangible	Macro	Secondary	8.2 (achieve higher levels of economic productivity)
Higher resource availability	Acquisition of natural resources	Greater availability or direct transportation to home country	Tangible	Macro	Primary	7 (access to affordable, reliable, sustainable and modern energy), 9.2 (promote inclusive and sustainable industrialization)
Improved tangible assets and products	Acquisition of capital goods, machinery etc.	Installation and use in home country factories or businesses	Tangible	Firm	Primary	9.5/9.B (upgrade the technological capabilities, support domestic technology development)
Higher employment and wages	Consequence of other home country effects		Tangible	Meso	Secondary	8.5 (achieve full and productive employment and decent work)
Economic growth	Consequence of all other home country effects			Macro	Tertiary	8.1 (sustain per capita economic growth in accordance with national circumstances), 1 (end poverty)

Source: ESCAP, 2020.



performance of the parent company (Chen, Li and Shapiro, 2012; Driffield, Love and Yang, 2014 and 2016). The result is an enhancement of scientific and technological capabilities, technology development, upgrading and innovation in developing country firms (SDGs 9.5, 9.B, 8.2, 12.A, 17.16), assisting them in their catch-up processes by complementing other types of know-how transfer that can occur through trade, for example. This can occur in a number of different sectors, including those particularly relevant to sustainability (SDG 7.A).

Fifth, MNEs investing abroad may adopt better managerial, labour, quality, environmental and other standards and practices from their overseas investment locations and acquired firms (Knoerich, 2017). Host countries at a higher development level in particular typically require investing MNEs to adopt specified environmental, labour, accounting and other standards, possibly inducing some companies to adopt these standards globally. Once these practices and standards are integrated into the MNEs' international and home country operations, various improvements in company operations should follow, from better products and processes to enhanced corporate social conduct and sustainable practices (SDG 12.6).

Sixth, the knowledge-generating efforts connected to OFDI will, over time, result in broader industrial upgrading. Direct acquisition of knowledge by firms from abroad is one avenue that will induce industrial upgrading, with developing country MNEs becoming more innovative and spending more on R&D as a result of their OFDI (Chen and Yang, 2013; Li, Strange, Ning and Sutherland, 2016). However, beyond such direct channels, other types of OFDI may induce domestic economic upgrading for other reasons. Exposure to foreign competition can, for example, induce an increase of the investing firm's international competitiveness vis-à-vis other firms, with positive effects on its home country production and business activities. OFDI can shift the labour force composition in the home country towards greater engagement in skill-intensive and higher-end productive activities (Knoerich, 2017). This can occur when efficiency-seeking OFDI moves low-skilled production activities to economies that are less advanced than the home country to save on labour costs and integrate in global value chains. In such circumstances, the home economy may respond by engaging its own labour force in higher-end activities. The result would be more capital- and skill-intensive production, greater "white collar" employment, wage increases and higher worker productivity in the home country (Moran, 2006). Such industrial upgrading from OFDI enhances scientific research, innovation and technological capabilities of industrial sectors in

developing countries, including technology development in sectors with particular relevance to sustainability (SDGs 9.5, 9.B, 8.2, 7.B and 12.A).

Seventh, as all the different knowledge-generating efforts and intangible returns from OFDI generate improved technological processes as well as greater capital intensity in production and other benefits, overall productivity of the investing MNEs increases (Cozza and others, 2015; Herzer, 2011b; Huang and Zhang, 2017; Li, Liu, Yuan and Yu, 2017). Such productivity gains could spread over time, yielding higher levels of economic productivity in a greater number of industrial sectors of the home country (SDG 8.2).

Eighth, MNEs use OFDI to acquire or gain better access to natural resources and raw materials in other countries, including oil and gas, metals and agricultural resources. As industrializing and rapidly developing economies generate more energy, construct more buildings, produce more output and consume higher quality food, the price and ease of access to the natural resources and raw materials required for such development processes assume greater importance. The international price of raw materials is reduced if more MNEs are involved in extracting them globally. Direct involvement in natural resources extraction abroad provides MNEs with more stable and secure access to such resources and the option of transferring them directly back to the home country (Cai, 1999; Deng, 2004; Knoerich, 2016 and 2017; Moran, 2010). The overall result is better access to affordable energy resources in the process of development and industrialization (SDGs 7 and 9.2).

Ninth, some MNEs investing abroad acquire and import tangible assets and products, such as capital goods, machinery and equipment, intermediary products and brands. When capital goods and machinery are installed in production processes or employed in other economic activities in the home economy, they can enhance domestic production capacities, technological development, productivity and value addition (SDGs 9.5 and 9.B). The use of some foreign intermediary goods in production processes, including those produced by an MNE's own overseas factories, might similarly improve production and lower costs, and create better marketing through the use of brands adopted from overseas (Knoerich, 2017).

Tenth, through their various positive contributions to the home economy, all these different types of home country effects have the potential to create, preserve and upgrade employment in the home country (Cozza and others, 2015; Liu, Tsai and Tsay, 2015). The exact

nature of the effect of OFDI on employment differs by type of investment, investment destination (e.g., in a more, or less, advanced economy than the home country), investment motivation, industrial sector and other factors. What is certain is that various kinds of OFDI contribute to the availability of full, productive and decent work in the home country (SDG 8.5).

Finally, as all the above home country effects contribute to all four components that make up GDP – investment, consumption, export trade and likely greater government expenditure due to higher tax revenues at home – it can be demonstrated that OFDI can have a positive effect on economic growth (Herzer, 2010). This is categorized as a tertiary impact in table 3.1, given that it is the outcome of OFDI for the home country in the longer term. The generation and maintenance of strong economic growth is important for the growth of per capita income in developing countries as well as the reduction and elimination of poverty (SDGs 8.1 and SDG 1).

### 3. Empirical evidence on home country effects

Knoerich and others (2021) have consolidated all existing empirical evidence on OFDI home country effects for both developed and developing countries globally. Extrapolating from this, table 3.2 provides a summary of the empirically examined home country effects in developing countries of Asia and the Pacific. As can be seen from table 3.2, China dominates by far this literature, with only a few studies examining home country effects in India, Malaysia, Singapore and Thailand. Overall evidence for the region therefore remains limited, highlighting the necessity to study other developing countries beyond China. All studies except one have found a positive relationship between OFDI and the examined home country effect. Most studies focus on intangible effects (five on know-how and five on productivity), with others examining domestic investment (two studies with positive findings and one with a negative finding), and exports, employment and economic growth (two studies each). Not covered are financial earnings, practices and standards, overall industrial upgrading, natural resources, and tangible assets and products. Further research on these areas will be vital to gaining a better understanding of the full spectrum of home country effects.

Using panel data from all ESCAP member States, ESCAP (2020) quantitatively examined the relationship between OFDI and four measures of home country effects – GDP, exports, inward

investment and R&D intensity – in Asian and Pacific economies.<sup>2</sup> These four variables were chosen as they represent different kinds of home country effects. The impact on GDP can be conceptualized as the final outcome of the other economic impacts resulting from OFDI. Change in exports is a particularly important home country impact for developing countries, resulting especially from market- and efficiency-seeking OFDI. Inward FDI is one type of investment in the home economy that might be expanded as a result of OFDI, particularly when OFDI integrates countries into global value chains and enhances regional cooperation which is a growing trend, especially in ASEAN. Finally, R&D expenditure is used as an indicator for R&D intensity and innovation that could be expanded as a result of technology- and strategic asset-seeking OFDI.

The study found that OFDI has a positive effect on GDP, confirming previous literature findings identifying such an impact (Chen, 2018; Chen and Zulkifli, 2012; Herzer, 2008 and 2010). Furthermore, every United States dollar spent on OFDI could increase GDP by US\$3.365 in developed countries of Asia and the Pacific, and the effect increases to US\$8.638 in developing countries. Greenfield OFDI was found to have a particularly positive effect on the GDP of developing countries in the region, and for ASEAN home countries in particular. For example, every United States dollar invested by an ASEAN member State in establishing a business in a foreign country could bring back as much as US\$2.977 return in GDP of the respective ASEAN home country. M&As were also found to have a positive effect on all home countries in the region.

OFDI was also found to have a positive effect and can promote home country exports, especially from ASEAN. For example, every United States dollar invested in OFDI by ASEAN member States could increase export value by US\$8.306; if the investment is greenfield, the export value could even increase by US\$9.263, whereas a US\$1 increase in outward M&As increases exports by US\$4.743 in all ESCAP member States, and by US\$5.133 for developing countries only, and by US\$5.529 for ASEAN member States.

Turning to inward FDI, OFDI's effect on it in countries of the region has been mixed. Total OFDI, greenfield investments and M&As only had a positive and statistically significant association with OFDI for ASEAN member States. This might suggest that OFDI can result in greater inward investments when economies become regionally integrated and assume

<sup>2</sup> A full methodological explanation can be found at <https://www.unescap.org/publications/studies-trade-investment-and-innovation-no-93-outward-foreign-direct-investment-and>



Existing evidence of home country effects in Asia and the Pacific

Country	Home country effect	Description	Source
China	Domestic investment (+)	OFDI complements domestic investment.	Ali and others, 2019
China	Know-how (+)	Chinese acquisitions in developed economies increase the patents of Chinese MNEs at home, regardless of ownership type.	Anderson, Sutherland and Severe, 2015
China	Economic growth (+)	OFDI from provincial firms and state owned enterprises has a positive impact on provincial economic growth.	Chen, 2018
China	Productivity (+), employment (+)	China's OFDI into Europe (especially greenfield) has a positive impact on productivity and scales of operation, measured by sales and employment.	Cozza and others, 2015
China	Know-how (+)	OFDI increases innovation performance, contingent on firm characteristics (in-house R&D, strategic orientation, international experience) and contextual factors (investment destinations, industry context).	Fu, Hou and Liu, 2018
China	Domestic investment (-)	OFDI crowds out domestic investment.	Gondim, Ogasavara and Masiero, 2018
China	Productivity (+)	OFDI promotes productivity of the parent firm, especially with high absorptive capacity related to product innovation, technology seeking motivation and OFDI in developed economies.	Huang and Zhang, 2017
China	Productivity (+)	The positive productivity effect varies depending on the parent firm and investment strategy – gains are higher for firms that are privately owned, have higher absorptive capacity and invest in OECD countries.	Li and others, 2017
China	Know-how (+)	OFDI has an impact on domestic innovation, contingent on absorptive capacity, foreign presence and the competition intensity of the local market.	Li and others, 2016
China	Employment (+)	OFDI has a positive impact on employment growth, especially in the tertiary industry.	Liu and Lu, 2011
China	Productivity (+), exports (+)	Production-oriented OFDI improves productivity, scale of production and exports.	Yang, 2017
China	Domestic investment (+)	Domestic investment responds positively to OFDI, especially in state-dominated industries.	You and Solomon, 2015
China	Productivity (+)	OFDI improves total factor productivity growth.	Zhao, Liu and Zhao, 2010
India	Know-how (+)	OFDI by three leading automotive firms has resulted in reverse knowledge transfers.	Mani, 2013
India	Know-how (+)	Positive impact on R&D intensity is stronger for developed host nations and joint ventures.	Pradhan and Singh, 2008
Malaysia	Economic Growth (+)	A positive long-run relationship between OFDI and economic growth.	Chen and Zulkifli, 2012
Malaysia, Philippines, Singapore, Thailand	Exports (+)	Complementary effects of OFDI on exports outweigh any substitution effects.	Ahmad and others, 2016

“+”: Positive home country impact; “-”: Negative home country impact; “+/-”: Impact uncertain

Source: ESCAP 2020.

complementary stages in global value chains, as is the case in ASEAN. This may suggest that developing countries cannot expect their greenfield investments overseas to result in greater inflows of productive capital unless they are strongly internationally or regionally integrated.

Finally, ESCAP (2020) found that both greenfield and M&A forms of OFDI lead to higher R&D expenditure and, by extension, greater levels of innovation in the home economy. Every US\$100 billion of investment from developing countries overseas could increase R&D expenditure as a percentage of GDP by 0.725 per cent. In ASEAN, the increase is even 1.9 per cent. This corresponds to the technology- and strategic-asset seeking motivation of OFDI as well as the possibility that increased offshoring induces upgrading of domestic economies through greater investment in R&D.

#### 4. Factors affecting the nature of home country effects

OFDI can have a positive effect on the development of home countries and contribute to achieving the SDGs in a variety of ways. Yet, the strength of these effects is highly dependent on the context in which OFDI occurs as well as the characteristics of the investments. One important factor is the characteristics of the host economy in comparison to the home country – for example, investments in more developed economies than the home country have greater potential to yield knowledge and productivity gains (Anderson and others, 2015; Cozza and others, 2015; Fu, Hou, and Liu, 2018; Huang and Zhang, 2017; Li and others, 2017; Pradhan and Singh, 2008), and the larger size of the developed market may result in greater financial returns and exports. OFDI in less developed economies, on the other hand, offers opportunities for financial earnings from low-cost production (Knoerich, 2017).

The characteristics of the investing MNE are another factor – more competitive, experienced and larger MNEs may, for example, generate greater home country effects, while small and medium-sized enterprises (SMEs) may face greater challenges when investing abroad due to their smaller size. State-owned enterprises (SOEs) can generate different home country effects than private MNEs, as they tend to be larger and better endowed with financial and other resources (Chen, 2018; Li and others, 2017; You and Solomon, 2015), cluster in key industrial sectors and engage in economic activities that are often of a strategic nature. The industrial sectors matter (Fu, Hou and Liu, 2018; Liu and Lu, 2011) as, for example, investments in a knowledge-intensive sector will have an impact on innovation

and productivity, while OFDI in natural resources will affect a country's resources security, and OFDI in low-cost consumer goods may yield financial returns. Differences between the primary, secondary and tertiary sectors are likely.

The nature of the home country effects will also differ by type and motivation of investment. For example, an investment in an R&D centre can give a firm a first mover advantage as well as yield innovation. A sales office will enhance market access that can boost home country exports while an overseas mining concession can secure the home country's access to resources. The construction of a factory abroad may result in greater exports and productivity of home-based capacity (Yang, 2017) as well as cost savings from low-cost production or the circumvention of tariffs. Another aspect is the entry mode of the investment. M&As, for example, are promising with regard to the acquisition of know-how, whereas greenfield OFDI may be better at generating financial earnings, exports and other benefits (Cozza and others., 2015) on the basis of an already existing strong business.

The degree of equity ownership over the foreign subsidiary is another important dimension, with larger equity shares likely to maximize the gains from OFDI. Wholly-owned subsidiaries and joint ventures could facilitate knowledge acquisition (Pradhan and Singh, 2008). Moreover, the time since the investment was made plays a role, with stronger home country effects to be expected with the passing of time. A further important factor is the policy context in home and host economies, especially the ways in which Governments regulate, facilitate and promote these investments. This is examined in greater detail in the next two sections.

Sometimes, home country effects may not be realized at all. This is likely the case when capital outflows are limited or when certain requirements for the realization of specific home country effects are not met. For example, the gains in technology, know-how and industrial upgrading depend on whether developing home countries and their firms have sufficient absorptive and learning capacity. MNEs need to have the ability to absorb and utilize foreign know-how (Cohen and Levinthal, 1990), including the ability to transfer know-how from abroad and utilize it in the home country, while the home economy needs to have the appropriate institutional, policy, legal and skills environment (Mowery and Oxley, 1995; World Bank, 2008). The degree of a firm's international experience may also matter. The existence of appropriate transmission channels – such as international financial instruments for the transfer of funds, within-firm arrangements for the transfer of

know-how, or pipelines and ships for the transfer of natural resources and capital goods – will affect the generation of home country effects. Companies abroad need to be available for acquisitions and willing to collaborate in areas such as transferring know-how, which is not always the case (Knoerich, 2017).

Some OFDI might have an outright harmful effect on the home country. As OFDI involves an outflow of capital, it may crowd out domestic investment, especially in the initial stages before investment begins to yield financial earnings. Capital outflows may harm the balance-of-payments and lead to currency depreciation. While these impacts are likely to be limited, as the sums involved in OFDI activities tend to be much smaller than other cross-border financial transactions such as international portfolio investments, they could be a problem for some low- and middle-income countries with few financial reserves. OFDI may also facilitate capital flight (Knoerich, 2018). Beyond these financial consequences, some OFDI may shift production and employment overseas (Debaere and others, 2010), reducing exports and other economic activity in the home country and harming tax revenues. Such harmful effects have, for example, been empirically identified for exports (Bhasin and Paul, 2016), and domestic investment (Al-Sadiq, 2013; Gondim and others, 2018). Moreover, OFDI may expand manufacturing and production in the home country that degrades the environment and exploits domestic labour. This can happen when MNEs that use overseas subsidiaries to enhance exports into foreign markets seek international competitiveness by producing in the home country with lower environmental and labour standards.

It is possible for OFDI to have favourable and unfavourable effects simultaneously – for example, benefiting high-skilled labour to the detriment of low-skilled workers, or having a limited effect in the short term but a stronger positive effect in the long term. As with trade, OFDI does at times produce winners and losers, but with the support of appropriate policies the positive effects should be greater and should be nurtured. To date, empirical findings appear to confirm this overall picture by producing mostly positive findings for many of the home country effect variables. Yet, some studies have obtained inconclusive or negative results, especially those examining some of the secondary and tertiary effects – domestic investment, productivity, employment and economic growth – where the relationship with OFDI appears particularly challenging for determination through statistical methods (Perea and Stephenson, 2018). In other areas, such as standards and practices, natural resources and capital goods,

empirical work remains limited or is unavailable. Thus, more detailed analyses of the various effects are still required, while empirical examinations should be expanded to cover a wider range of countries with different levels of economic development and varying institutional settings.

Given that the strength of OFDI home country effects can vary as a result of many different factors, Governments can play an important role in monitoring and influencing the consequences of OFDI. Policy and regulations can promote the positive effects of OFDI, while aiming to mitigate any unfavourable effects. For example, Governments play a major role in maximizing the absorptive capacity of countries and their firms through appropriate policies on science, education, legal environment and other dimensions. There is thus an important role for Governments in creating an environment that is favourable to the realization of positive home country effects.

### C. Home country measures to support outward foreign direct investment

Governments around the globe are increasingly recognizing that they must appropriately manage growing levels of OFDI flows and the resulting home country effects, in particular with a view towards achieving the SDGs. Unfortunately, while the role of Governments in managing inward investment has been widely covered and documented in the literature, the corresponding research and analysis of OFDI is very limited. A notable exception is the overview by Sauvnt and others (2014) of OFDI institutions, policies and home country measures (HCMs) in the top 10 developed and emerging economies by OFDI flows. Their study documented a wide variety of institutions, services, financial and fiscal measures, insurance and treaties relevant to OFDI that have been found in the examined countries.

Sauvant and others (2014) found that the use of HCMs has a long tradition in developed economies, in parallel with decades of growing capital outflows and the internationalization of developed economy firms. However, in developing economies OFDI has faced many restrictions, and the use of HCMs to support and facilitate OFDI has been rare. Only recently have some Governments in these economies adopted more wide-ranging HCMs in response to growing OFDI flows after recognizing their potential to support the home economy. Beyond a few leading developing economies, however, the active use of HCMs to promote OFDI remains limited in developing countries (Sauvant and others, 2014).

An equivalent picture presents itself in Asia and the Pacific. Apart from Japan, which has adopted a considerable number of HCMs, available evidence from developing countries in the region suggests their use beyond OFDI restrictions has been rather sporadic. China is an exception, being the first developing country in which HCMs have been widely adopted. In the 2000s, the Government of China introduced a broad range of HCMs with the aim of supporting OFDI that would yield home country effects (Knoerich, 2016). In addition, the existence of HCMs has been documented in India, Malaysia, the Russian Federation and Singapore. Singapore was the first smaller country in Asia to introduce a wide range of HCMs, similar to those used in China. However, beyond these larger and relatively developed economies in the region, there is very little evidence in the literature that HCMs beyond restrictions exist in other countries.

For Governments in developing countries, the particular challenge is how to make OFDI form part of their broader development strategy, complementing other development policies in areas such as inward FDI, trade and migration (Knoerich, 2016 and 2017; Sauvart and others., 2014; Stephenson and Perea, 2018). While some HCMs will have wide applicability in many economies, country-specific strategies to maximize developmental outcomes may at times be necessary to address particular characteristics of home economies, national companies and domestic institutions (Kuźmińska-Haberla, 2012). As with inward FDI, the potential contributions of OFDI to sustainable development of home countries in Asia and the Pacific can be better realized if the right conditions and policies are in place. This includes having the right quantity and quality of OFDI, with investment projects in the sectors relevant to home country development. The development and operationalization of OFDI policies and regulatory frameworks can help to realize the full sustainable development potential of OFDI in economies of Asia and the Pacific.

### 1. Different types of home country measures

The definition of home country measures has varied from study to study. A widely accepted version emerged from an UNCTAD expert meeting on HCMs in November 2000 (UNCTAD, 2001): “HCMs are all policies, regulations, measures and institutional adjustments implemented by the home countries of firms that choose to invest abroad in order to manage and encourage OFDI flows to other countries.” Contrary to previous definitions, this includes assigning responsibilities to deal with OFDI to relevant institutions. Table 3.3 provides an overview

of HCMs. Its aim is not to be comprehensive, but rather to offer a snapshot of all common options that have been identified to date. The measures and categories may evolve over time, especially as new ones are identified, or as policy innovations occur. The following paragraphs discuss each category in further detail.

The first consideration is the assignment of responsibilities for OFDI and the management of all the HCMs listed in table 3.3 to relevant institutions. Government departments and ministries, such as Ministries of Economic Affairs, Ministries of Commerce, Ministries of Economy, Trade and Industry and others, often deal with matters of broader economic policy, law, finance and international treaty negotiations relevant to OFDI. In China, for example, the Ministry of Commerce, the People’s Bank of China, the State Council, the National Development and Reform Commission (NDRC) and others have responsibilities related to dealing with aspects relevant to OFDI (Luo, Xue and Han, 2010). Specific investment promotion tends to be managed by investment promotion agencies (IPAs), although many of these have focused on inward investment, thus needing adjustments to additionally assume responsibility for OFDI. A recent WAIPA and World Bank survey of IPAs, found that 31 per cent of all IPAs globally have a mandate to cover OFDI in addition to inward FDI (Sanchiz and Omic, 2021). However, several recent reports have suggested that IPAs should not extend their mandate to cover OFDI as it will limit their effectiveness in attracting inward FDI (Heilbron and Whyte 2019; World Bank, 2021; Lim, 2018).

Trade promotion agencies fulfil similar functions. In Singapore, for example, the main agencies involved in promoting OFDI are the Economic Development Board (EDB) and Enterprise Singapore. Originally Singapore’s IPA for inward investment, the EDB has since 1993 assumed some functions related to the promotion of OFDI (UNCTAD, 2006, p. 214). Enterprise Singapore, which has been involved in many aspects of OFDI promotion (Sauvart and others, 2014), is a government agency under the Ministry of Trade and Industry that in 2017 was formed by the merger of two separate entities – International Enterprise Singapore and the Standards, Productivity and Innovation Board. Moreover, export credit agencies and development finance institutions can support OFDI through the provision of tailored financial services such as loans and insurance. While created for reasons other than OFDI, special purpose institutions can be involved in activities beneficial to OFDI, such as when they establish modalities for international cooperation. Sometimes, private organizations can get involved if the Government

outsources some of its responsibilities to them. Finally, an institution or committee could be put in place to coordinate all activities relevant to OFDI that are undertaken by these various institutions. In an extreme case, this could be a “one-stop shop” for OFDI services. Overall, the institutional setup varies from country to country.

Governments may find it necessary to implement regulations on OFDI. One aim of such regulations is to assure that OFDI does not harm the home economy, thereby preventing the emergence of unfavourable home country effects. Common, especially in developing countries, are restrictions on OFDI, often in the form of requirements for governmental approval of investment projects and various types of foreign exchange control, such as limiting access to foreign exchange or requiring the repatriation of investment earnings (Kuźmińska-Haberla, 2012). This is an opportunity to prevent capital flight and to screen investments on the anticipated home country effects. Many developing countries have loosened such restrictions over time. For example, India has been liberalizing OFDI since the 1990s, reducing restrictions and broadening the range of supportive HCMs (Sauvant and others (2014). The Russian Federation has generally allowed OFDI, with some restrictions in individual cases (Perea and Stephenson, 2018), while China has simplified its approval procedures and eased foreign exchange restrictions over time.

Governments can also regulate the activities of enterprises overseas after they have made their investments. Some stipulate requirements for corporate conduct overseas, including adherence to principles of responsible business conduct (RBC) or corporate social responsibility (CSR) on environmental sustainability, protection of labour rights, treatment of local communities affected by an investment etc. Governments may decide to monitor OFDI projects or require firms investing overseas to report back to them, to ascertain whether investments meet RBC/CSR and other requirements and are in the national interest. Such requirements are an opportunity for Governments to gather information on the developmental outcomes of OFDI projects for host countries. China, for example, has a system to monitor the overseas operation of Chinese firms and increasingly requires adherence to codes of conduct on RBC/CSR. India requires some companies to submit annual performance reports on their investments (Perea and Stephenson, 2018). Overall, such regulations tend to make undertaking overseas investments more bureaucratic for firms, with restrictions normally having the effect of reducing OFDI flows.

The first set of supportive measures that a government can provide is the provision of various services related to OFDI. These include offering information on the investment environment in other countries, on approaches to undertake OFDI in these countries and on the Government’s HCMs affecting overseas investments. Beyond the mere provision of information, Governments can organize investment missions to host countries aimed at exploring investment conditions there. Matchmaking services can help to establish networks between home country firms and Governments or businesses overseas. This can be done either directly and in person, or by maintaining a database of such contacts and making it accessible to investors. Cooperation between IPAs in home and host countries can facilitate such investment missions and matchmaking services. Finally, Governments can provide various education and training services on issues relevant to investing abroad and managing a subsidiary in a different country. Some government institutions may even get more involved in the strategic planning of firms for their overseas investments by providing direct consultancy services and business advice to firms. The Governments of China, India, the Russian Federation and Singapore have all offered a selection of these services to companies investing abroad, including information services and overseas missions (Sauvant and others, 2014). When providing this information and concrete investment advice, Governments have an opportunity to raise development concerns with investors and encourage them to consider home country effects when developing their investment plans.

Many Governments offer financial support for OFDI projects. A first type of funding are grants offered for comparatively smaller investment-related activities, such as feasibility studies and market research, and the establishment of initial overseas offices before deciding on the full implementation of an investment project and the organization of staff and manager training. Grants also fund consultancy fees and work placements of staff for training purposes (e.g., in overseas subsidiaries). Loans offered to MNEs to fund their investment projects tend to be larger financial commitments. These can be concessional loans offered by a Government at lower rates and better terms than available on financial markets (e.g., with longer grace periods). Non-concessional loans, in turn, offer no preferential terms but may be more accessible to some investors, such as SMEs, which experience limited access to capital from financial markets. Loans can be provided in various forms of structured financing that could, for example, link repayment to investment success or allow loans to be convertible into shares. Governments have the



Home country measures

Category	Measure	Sub-category	Applicability/ eligibility	Desired impact
<b>Institutions</b>	Government departments and ministries		Responsibility for all OFDI or specific type of OFDI or company	Responsibility for all home country effects or specific effects
	Investment and trade promotion agencies (central and local, at home and abroad)			
	Export credit agencies (e.g., export-import banks)			
	Development finance institutions			
	Special purpose institutions			
	Business associations			
	Private organizations (when fulfilling governmental mandates)			
	Coordinating institution or mechanism			
<b>Regulations</b>	Restrictions	Investment approval Foreign exchange controls	All OFDI, or preference for specific type of OFDI, e.g., in terms of investment motivation, strategy, entry mode, destination and size, or specific type of company, e.g., by size, ownership, nationality, and business experience, plus sector and other relevant criteria, including aiming for OFDI that would otherwise not occur or where the realization of home country effects is evident	Primarily to prevent negative effects
	Requirements	Requirements for corporate conduct overseas Reporting requirements Monitoring of OFDI projects		
<b>Services</b>	Information support	Provision of information on host countries Provision of information on OFDI Provision of information on HCMs		All home country effects, or particularly aimed at specific effects, e.g., financial earnings, export/output earnings, domestic investment, know-how, standards and practices, industrial upgrading, productivity, resources capacities, tangible assets and products, employment, economic growth
	Investment missions Matchmaking services	Connecting with governments/business overseas Maintaining business matchmaking databases		
	Education and training In-depth consultancy and advice			
<b>Financial support</b>	Grants	Pre-investment feasibility studies and research Establishment of overseas offices		
	Loans	Training and human capital development Consultancy fees		
	Financial guarantees	Work placements (for training purposes)		
	Equity participation	Concessional loans Non-concessional loans		
		Structured financing options		
		Risk-sharing arrangement		



**Table 3.3** (continued)

Category	Measure	Sub-category	Applicability/eligibility	Desired impact
<b>Fiscal support</b>	Tax exemptions	Exemption from corporate income tax		
	Corporate tax relief	Tax deductions		
	Tax deferral (for overseas income)			
	Tax credits			
	Allowances for qualifying activities			
<b>Investment insurance</b>	Political risk insurance			
<b>Treaties</b>	Investment agreements	Bilateral and plurilateral treaty negotiation		
	Double taxation treaties	Membership in dispute resolution institutions Negotiating reduction in barriers to entry		
<b>Operational support</b>	Policy-related support overseas	Support with establishment in host country Political and diplomatic backing		
	Mobilize domestic support	Policy coordination with host governments Inter-firm collaboration on OFDI		
	Mobilize auxiliary services overseas	Encourage OFDI financing by banks Mobilising OFDI-associated service providers Establish centres or parks in host country		
<b>Maximizing benefits</b>	Enhancing home country prerequisites	Measures to boost absorptive capacity Measures to promote competitiveness		
	Improving transfer channels	Promoting domestic inter-firm linkages		
	Encouraging generation of effects			
<b>Monitoring and evaluation</b>	Feedback mechanisms			

Source: ESCAP 2020, based mostly on Sauvart and others, 2014; Stephenson and Perea, 2018; and Kuzminska-Haberla, 2012 (for restrictions).

option to share the risk of providing loans for OFDI with private financial institutions or international organizations. A further category of financial measure is for Governments to offer financial guarantees to private lenders on the repayment of loans they provide for specific OFDI projects. This reduces the risk to private lenders, enabling them to make more capital available to fund outward investments. A final type of financial support is direct equity participation by a Government in the foreign subsidiary established by an investment. These arrangements tend to involve minority stakes in foreign affiliates and may include exit options such as allowing the re-purchase by the company of shares owned by the Government (Sauvant and others, 2014). Loans and other forms of financial support have, for example, been offered by the Singaporean EDB and Enterprise Singapore, and the Export-Import (EXIM) Banks of China, India, Malaysia and Thailand (Sauvant and others, 2014; UNCTAD, 2006). Financial HCMs offer Governments an opportunity to financially support investment activities that yield positive home country effects.

Another option is to offer fiscal support for OFDI. This is a complex legal area as the support offered depends on the tax systems involved, in particular whether the home country taxes its companies and foreign affiliates either worldwide or just in its own territory. Fiscal support can take the form of exemptions from certain components of corporate income tax or may be a deduction of tax. Governments may also relieve certain types of companies at specified stages of an investment from corporate tax or allow MNEs to defer tax payments on overseas income. It is possible to offer tax credit on certain types of investment-related expenditures or to make allowances for certain qualifying activities related to an investment. Tax exemptions and other forms of fiscal support have been offered by China (the State Administration of Taxation), Malaysia, the Russian Federation (regulated by the Ministry of Finance) and Singapore (Sauvant and others, 2014). Fiscal HCMs offer Governments an opportunity to support investment activities that yield positive home country effects, especially in investment phases that are critical to the success of an investment.

Given the political risk involved when making investments abroad, especially in sectors involving large-scale investments such as in natural resources, MNEs sometimes seek to reduce their exposure to such risks by purchasing investment insurance. Such political risk insurance can be provided by a public institution, often the home country's export credit agency such as Sinosure in China, the Export Credit Guarantee Corporation of India Ltd., the EXIM Bank of Malaysia and the Russian Agency for Export Credit and Investment Insurance (EXIAR). Enterprise

Singapore has coordinated the provision of political risk insurance by brokers and insurance registered in the country (Sauvant and others, 2014). Investment insurance may be offered, especially for investment projects that promise to have positive developmental effects for the home country.

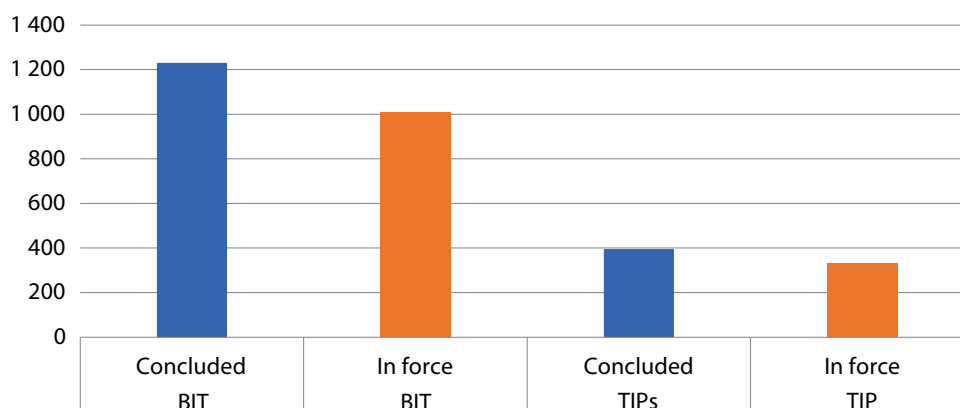
Beyond these various forms of domestic assistance in monetary form, Governments can negotiate international treaties containing provisions that are favourable to OFDI. Developing countries in Asia and the Pacific have signed a considerable number of bilateral investment treaties (BITs) and treaties with investment provisions (TIPs), as shown in figure 3.5. Bilateral or plurilateral investment agreements and trade agreements with investment provisions have for decades been used by developed economy Governments to negotiate investment protection and international market access on behalf of their firms. Although developing countries have tended to negotiate these treaties primarily to attract inward FDI, the protection and market access provisions offered in these treaties could facilitate their OFDI; in the future, Governments of developing countries may need to pay closer attention to the objective of protecting their own overseas investments when negotiating these treaties. China, for example, has increasingly considered the interests of its firms investing abroad in treaty negotiations. ASEAN is also working its way towards this with the ASEAN Comprehensive Investment Agreement.

In parallel to the negotiation of investment treaties, Governments may need to consider what membership in dispute resolution institutions (e.g., the International Centre for the Settlement of Investment Disputes or other arbitration institutions) best supports their interests and that of their firms investing abroad. Beyond formal investment treaty negotiations, Governments might seek to negotiate reductions in market access barriers through government-to-government commercial diplomacy and other international forums (Stephenson and Perea, 2018). Finally, avoidance of double taxation treaties (DTTs) can support the operations of MNEs with regard to taxation matters, especially by reducing the burden of double taxation or facilitating the provision of fiscal support as outlined above. Overall, Governments have the opportunity to draft and negotiate treaty texts that promote positive development effects from OFDI for home countries.

Once investments have been made, HCMs can provide operational support while these investments are ongoing. First, this includes assistance with policy-related challenges that investors encounter abroad, such as through support for achieving market access and overcoming entry barriers and other



**Number of international investment agreements signed by developing countries in Asia and the Pacific**



Source: ESCAP calculation based on UNCTAD Investment Policy Hub.

bureaucratic hurdles (Stephenson and Perea, 2018). Governments can provide political and diplomatic backing in investment-related dealings with the host country's authorities. China, for example, has provided diplomatic support for the realization of large-scale projects overseas, especially by SOEs, and its flagship foreign policy project, the Belt and Road Initiative, supports OFDI. The Russian Federation has provided diplomatic backing for individual larger investment projects undertaken by its SOEs (Sauvant and others, 2014). Governments may also coordinate investment policies with host country authorities. Such coordination could be used to ascertain that a home country's HCMs align rather than conflict with the host country's policies on inward investment. Alternatively, home and host country IPA coordination could also support investors.

Second, Governments can also mobilize domestic support for OFDI, e.g., by encouraging the private sector to support OFDI projects. Firms could be encouraged to form collaborations for the purpose of investing abroad, and banks and financial institutions could be encouraged to consider funding OFDI projects. Third, Governments can mobilize the creation of auxiliary services overseas. This includes mobilizing relevant service providers such as banks, legal firms, consultancies etc. to support the investing firms through the establishment of their own presence in the host country. The private sector or the Government itself can establish centres or industrial parks in host countries in which investors can more comfortably locate their subsidiaries and launch their overseas operations. China, for example, has encouraged the establishment of special economic zones (SEZs) overseas to support Chinese investments into those zones, and Singapore has financially supported the establishment of offices in

the Sino-Singapore Tianjin Ecocity as a way to promote strategic cooperation with China (Sauvant and others, 2014). Governments have the opportunity to focus their operational support in areas where positive development effects from OFDI are prevalent.

Maximizing benefits of OFDI for the home country through suitable economic policies is another important category of HCMs (Stephenson and Perea, 2018). A distinction can be made between three types. First, the prerequisites in the home country needed for the generation of home country effects can be enhanced. This includes measures to boost absorptive capacity, which are important in making sure know-how transferred home from overseas investment projects can be assimilated into domestic innovation systems, and economic activities to promote broader industrial upgrading. The development of skilled human capital through education, training and investment in domestic innovation in corresponding sectors would be some of the measures to boost absorptive capacity. Domestic science and technology policies, public R&D investments, improvements in education and other initiatives have, for example, considerably boosted the absorptive capacity of Chinese firms and the entire country. Similar measures can be put in place to boost the international competitiveness of firms more broadly (Porter, 1990), enabling them to compete effectively when they undertake overseas investments.

In addition, Governments can promote linkages between domestic firms to facilitate spill-over effects (Stephenson and Perea, 2018), such as by facilitating the establishment of collaborations and networks among firms in the domestic economy. They can

specifically support companies' abilities to link and integrate into global value chains. Second, Governments could identify ways to improve the channels through which OFDI generates home country effects. This might involve facilitating financial transfers or enhancing transport routes and logistics between home and host country. Third, Governments can encourage firms to engage in the generation of home country effects. For example, subsidiaries can be encouraged to source components from the home economy or make domestic investments associated with their OFDI. This effectively implies that in addition to promoting the investment itself, Governments should consider promoting the activity associated with the investment that will generate home country effects, such as additional exports, domestic investments, employment generation or the return flows of natural resources.

Finally, procedures for monitoring and evaluation of the effectiveness of HCMs could be put in place, by introducing appropriate feedback mechanisms. This could ensure and verify that HCMs yield the intended effects and are cost-effective (Stephenson and Perea, 2018). Companies investing abroad could be surveyed about the extent to which they have taken advantage of available HCMs and benefited from them. A similar option is the organization of listening sessions with company representatives. Such surveys could also be used to ascertain whether HCMs have promoted the generation of home country effects, in parallel with quantitative and qualitative measurements of firm-level and economic effects in the home country. Overall, more work is needed to develop appropriate measurements for the effectiveness of HCMs in facilitating the generation of home country effects.

There are some indications that Governments follow a specific policy path in the process of developing HCMs. It begins with the reduction of restrictions on OFDI, followed by the provision of information services and negotiations of associated international treaties. A further step is the provision of political risk insurance, followed by the introduction of financial and fiscal services. Operational support and maximizing benefits would be among the last HCMs to be introduced. While this approach has been observed, countries may differ in the extent to which they follow this policy path (Sauvant and others, 2014; Knoerich and others, 2021). Individual countries might leapfrog stages if they see a potential for OFDI to help speed up development and technological catching up. Other Governments may be more sceptical about the proposed virtues of OFDI and liberalize more slowly.

A brief survey of outward investment restrictions in the Asia-Pacific region (around 2013) found a mixed picture: Azerbaijan, Cambodia, Kazakhstan, Malaysia, Mongolia, the Philippines, the Russian Federation, Tajikistan and Thailand had no restrictions, apart from a requirement to register or notify an investment in some cases. The Solomon Islands and Sri Lanka allowed OFDI, subject to conditions. As discussed above, China and India had approval requirements for some categories of investments. Approval for all OFDI was still required in Bangladesh, Fiji, the Lao People's Democratic Republic, Nepal, Pakistan, Samoa, Tonga and Viet Nam, sometimes with further restrictions attached or allowing exemptions (Sauvant and others, 2014). This confirms that countries have different preferences in how they deal with OFDI, which is not necessarily connected with development status or country size.

## 2. Targeting home country measures

While Governments can apply these HCMs to all companies of the home country and all types of OFDI projects, this is not always the case. Sometimes there is a preference to aim towards specific types of OFDI projects and particular types of firms when adopting OFDI projects and particular types of firms when adopting OFDI projects. Such an approach can support the aim of maximizing development effects of OFDI for the home country, and the strategy can be made to correspond to economic realities as well as the development strategies and priorities of the Government. The nature of such an aim and underlying strategy might differ between categories of HCMs. Table 3.3 does not specify the applicability of individual HCMs to specific investments or firms, keeping this aspect vague due to limitation in availability of such knowledge and evidence. Future research and policy analysis should aim to identify and develop more specific strategies.

Regarding the pursuit of specific OFDI projects, Governments can consider various aspects. They could select projects with a preferred investment motivation, such as strategic asset-seeking when industrial upgrading is a priority, market- and efficiency-seeking when enhancing exports is a particular development goal, or resource-seeking FDI when the home economy is in need of greater resources security. The Government of China has directed HCMs to investments that it considers to be in line with its development priorities, such as OFDI that increases access to know-how, natural resources or trade opportunities (UNCTAD, 2006).

Governments could differentiate their provision of HCMs by investment strategy, with a preference for OFDI projects with strategies that comply with

development objectives, or projects that promise to yield positive home country effects. An OFDI strategy aimed at integrating a company into global value chains would be one example.

There may be preferences for certain types of entry mode, such as acquisitions or R&D centres for accessing know-how, or the establishment of greenfield factories for low-cost production or better market access. The EXIM Bank of India, for example, has provided equity and debt financing of overseas acquisitions (Sauvant and others, 2014). Singapore has supported foreign acquisitions with tax relief provided that the investment results in the company's expansion in Malaysia and Singapore has financially supported overseas acquisitions aimed at bringing technology back home and using it in domestic operations (Sauvant and others, 2014).

HCMs could specifically support OFDI in investment destinations where the generation of positive home country effects is likely, such as developed economies for the generation of know-how or resources-rich countries for access to raw materials. For example, China's NDRC has published three lists of preferred destination countries and sectors (Knoerich, 2016), and Enterprise Singapore has shown a preference for financing investments in some developing and emerging markets (Sauvant and others, 2014). The Sino-Singapore Tianjin Ecocity even aims at China as a specific country of investment. Moreover, India has maintained some restrictions on OFDI in neighbouring countries (Perea and Stephenson, 2018). Such targeting by investment destination can be coordinated with policies on inward investment in host countries.

Investment size can also be a criterion for the provision of HCMs, especially when it comes to issues of regulatory restrictions. It is commonplace to reduce requirements for investment approval for smaller investments first. India, for example, introduced an automatic route for approval of smaller investment projects (Sauvant and others, 2014).

Different categories of HCMs could also be applied to different types of companies. Company size is an important dimension in this context. SMEs in particular are often in a disadvantaged position and have limited financial and other resources available for OFDI. Yet, in most economies they play a very important role. HCMs may therefore aim at supporting SMEs, as has for instance happened in India, Malaysia and Singapore (Sauvant et al., 2014; UNCTAD, 2006). Despite the focus in many countries on SMEs, in certain circumstances the support of large firms might be needed as well.

Another dimension is company ownership, referring to the consideration whether HCMs should support private sector enterprises or SOEs. HCMs can apply to both state-owned and private firms, although specific regulatory frameworks sometimes differ between the two. China and the Russian Federation, for instance, support their SOEs investing abroad with diplomatic backing. Overall, recent research has found that there is no preference for either form of ownership in most countries (Sauvant et al., 2014).

Company nationality may be another consideration, as a government may either apply HCMs only to domestic parent companies or broaden them to subsidiaries or affiliates of foreign firms in the home country. To be eligible for financial support from Enterprise Singapore, for instance, companies need to be registered and have three strategic business functions in the country (Sauvant et al., 2014). A project that specifies the nationality of two countries as criteria for eligibility is the Malaysia-Singapore Third Country Business Development Fund. It was established to financially support joint investments by companies from both countries into third countries, with a focus on South-East Asia (UNCTAD, 2006).

Governments may also have a preference for supporting companies with greater business experience, especially with overseas investments, as the likelihood of a positive outcome from the investment may be heightened. A company's eligibility for HCMs could be made dependent on the extent to which its OFDI promises to generate positive and desired developmental outcomes.

The sector of the company and investment is another dimension by which to differentiate the provision of HCMs. The Government may aim to support particular sectors, for example those it considers as priority sectors in its development strategy and those which promise to maximize the home country effects from OFDI, given the particular economic circumstances of the home country. Sectors with a lot of OFDI in areas relevant to home country development (e.g., generating know-how or exports) could be prioritized. This is a very complex area, given the large number of different subsectors for consideration within the primary, secondary and tertiary sectors. Every country has a different sectoral composition, making the choices on which sectors to support through HCMs quite an individual matter. For example, the Malaysian EXIM Bank has offered financial support for infrastructure, manufacturing and other developmental projects (UNCTAD, 2006). It has even specifically supported the overseas expansion of Malaysian restaurants, and acquisitions in the services and manufacturing sectors (Sauvant

and others, 2014). India has prohibited OFDI in real estate and restricted OFDI in financial services, with investments in other sectors subject to approval by the Reserve Bank of India (Perea and Stephenson, 2018).

OFDI that would otherwise not occur could also be specifically targeted through HCMs. Various constraints may prevent companies from investing overseas such as, for example, a shortage of funding for such investments or a lack of awareness of existing opportunities. HCMs can help companies overcome these and other constraints. As already mentioned, SMEs might be a particular target group to look for when seeking to identify such companies with potential but yet-to-be realized investments.

The final column in table 3.3 suggests that HCMs should aim at investments and companies in ways that support the realization of home country effects. All home country effects outlined in table 3.1 could potentially be the target of such efforts, and Governments may either aim to select some of them as focus areas at which to aim HCMs or prefer to support OFDI projects across the board. Enterprise Singapore has, for example, required that supported OFDI projects complement operations in the home economy and have spin-offs for the Singaporean economy (UNCTAD, 2006). However, the direct connection between individual categories of HCMs and development outcomes from OFDI is often difficult to establish with certainty, given limitations in available knowledge and evidence in this area. Knoerich, Stephenson and Taylor-Strauss (2021), have made considerable inroads into this area with their Policy Toolkit for Maximizing OFDI for Home Country Sustainable Development.

## **D. OFDI and home country sustainable development: A menu of options for policymakers**

### **1. Chapter summary**

This chapter highlighted several reasons why home country effects from OFDI should, to a greater extent, be built into the investment policies and measures of developing countries in Asia and the Pacific. First, OFDI from countries in the region has grown considerably in recent years. This applies not only to OFDI from larger economies, but also increasingly to smaller countries. Governments in Asia and the Pacific therefore need to be aware of the implications resulting from the growth in OFDI for their economies and development.

Second, OFDI has the potential to facilitate positive development outcomes in home countries. This chapter took stock of the home country effects that have been found to exist and the factors influencing their effectiveness, and identifies 11 home country effects that can contribute to rising economic growth. Their relevance for global development policy has been established by linking home country effects to specific SDGs, demonstrating how OFDI needs to form part of the agenda to achieve them. Available evidence suggests that home country effects do occur in many countries, contexts and circumstances. Quantitative analysis by ESCAP confirms that OFDI has positive impacts on GDP, exports, inward FDI and, in most cases, on R&D. The ESCAP analysis also suggests that deeper regional integration may positively affect these impacts – something which lends further support to the need for countries in the region to move further towards enhancing regional economic integration and cooperation. It is important to note however, that in some circumstances, unfavourable implications may also result from OFDI. The evidence of positive effects should, nevertheless, be sufficient to compel Governments in developing countries to accept that home country effects need to be considered in the process of investment policymaking.

Third, this chapter took stock of the HCMs that have been used to facilitate, promote and regulate OFDI. It then considered how Governments can use HCMs towards specific investments, companies and sectors to increase the likelihood of achieving the desired economic outcomes. HCMs have been used for many years by Governments in developed economies and some larger developing countries (especially China). Smaller developing countries, including those in Asia and the Pacific, appear to be behind in the utilization of HCMs, despite growing OFDI flows. The fact that other countries have already developed HCMs is another reason for Governments of smaller countries to equally consider them in the development of their investment policies.

### **2. A menu of options to develop OFDI policies**

Pooling the findings of this chapter yields a menu of options that Governments can consider for developing OFDI policies. This menu of options is presented in table 3.4 and consists of four categories. The starting point for Governments would be to identify the home country effects they would like to facilitate, based on existing development priorities, the characteristics of the home economy and its firms, and other considerations. Effectively,



**A menu of options for Governments to leverage OFDI for home country development<sup>3</sup>**

Home country effects	Influencing factors	Home country measures	Targeting
<ul style="list-style-type: none"> <li>• Financial earnings</li> <li>• Export/output</li> <li>• Domestic investment</li> <li>• Know-how</li> <li>• Improved standards</li> <li>• Industrial upgrading</li> <li>• Productivity</li> <li>• Resources capacities</li> <li>• Tangible assets/products</li> <li>• Employment</li> <li>• Economic growth</li> <li>• [...]</li> </ul>	<ul style="list-style-type: none"> <li>• Host economy</li> <li>• Investing MNE</li> <li>• Industrial sector</li> <li>• Investment motivation</li> <li>• Entry mode</li> <li>• Degree of ownership</li> <li>• Time since investment</li> <li>• Policy context</li> <li>• Absorptive capacity</li> <li>• Transmission channels</li> <li>• [...]</li> </ul>	<ul style="list-style-type: none"> <li>• Institutions</li> <li>• Regulations</li> <li>• Services</li> <li>• Financial support</li> <li>• Fiscal support</li> <li>• Investment insurance</li> <li>• Treaties</li> <li>• Operational support</li> <li>• Maximizing benefits</li> <li>• Monitoring and evaluation</li> <li>• [...]</li> </ul>	<ul style="list-style-type: none"> <li>• Investment motivation</li> <li>• Investment strategy</li> <li>• Entry mode</li> <li>• Investment destination</li> <li>• Investment size</li> <li>• Company size</li> <li>• Company ownership</li> <li>• Company nationality</li> <li>• Business experience</li> <li>• Industrial sector</li> <li>• OFDI that would otherwise not occur</li> <li>• Realization of home country effects</li> <li>• [...]</li> </ul>

the home country effects would be the goals to be achieved by Governments through appropriate HCMs. The factors that can influence the effectiveness of specific home country effects then need to be taken into account in the specification of appropriate approaches to leverage OFDI for home country development. The available HCMs are listed in the third column, with Governments having to choose those measures that are most promising for achieving the aspired home country development effect, taking into account available capacities and resources, policy priorities and other issues. Finally, Governments have to choose among different options for aiming HCMs at specific investments, companies or sectors. The menu of options reduces complexity by presenting the available options in one framework. It is not supposed to be fully comprehensive – new options can be added in the future when they are discovered, as indicated by the last dot at the end of each column.

The menu makes it possible to work through the four categories to develop strategic approaches for OFDI policy. For example, if the desired home country effect is to enhance export earnings (first column of the menu of options), the next step will be to determine which factors might influence the generation of this effect (second column). Particularly

promising for the generation of home country exports might be investments with market-seeking motivations, and in sectors where the home economy has strong, internationally competitive products. In light of these objectives and considerations, a Government might, as a third step, put corresponding HCMs in place (column 3), e.g., those that focus on providing services to help market-seeking investors enter overseas markets. Such services could involve designating an agency to provide information on overseas markets and organize investment missions to promising host countries. That Government could also offer operational support by establishing links with relevant government agencies in the host country as well as encouraging banks and law firms to provide services that support market-seeking investors. As a final step, that Government could aim the HCMs not only towards market-seeking investors, but also towards promising sectors or firms. For example, the responsible agency could tailor its services to sectors that are known to be internationally competitive. Alternatively, its service delivery could be channelled especially to supporting promising OFDI projects by companies with known difficulties in internationalization and foreign market access, as is often the case with SMEs due to their size.

<sup>3</sup> Multiple combinations of options are possible and depend on the priorities and development characteristics of the home countries developing the OFDI policy. The purpose of this table is to introduce a simplified version of the menu of options. A detailed version of this menu of options, including possible combinations, can be found in Knoerich, Stephenson and Taylor, 2021.

The combinations of viable options across the four categories will vary depending on the home country effect to be achieved and other factors, such as the characteristics of the home economy and its firms. When the objective is to enhance domestic know-how rather than seek markets, the focus might rest more on full acquisitions in developed economies in sectors where domestic know-how is needed and absorptive capacity is sufficient, with promotion efforts focusing on offering financial support and matchmaking services. If resource security is to be achieved from OFDI, the acquisition of foreign mining concessions will be important, and Governments might support this through investment treaties, political risk insurance and diplomatic backing. HCMs would be aimed at large natural resources companies with many years of mining experience. These are just some general examples of how the options in the four categories can be combined to develop appropriate and suitable investment policies aimed at nurturing specific home country effects. There are likely many possible combinations, with some working better than others. A future effort could be made to identify those combinations that come close to resembling “best practice” in OFDI policymaking.

Several important issues must be taken into account when considering the possibilities offered in the menu of options. For any home country effect to be selected for policy support, a convincing economic case needs to be made that it can indeed be achieved in the country given the available economic circumstances, sectoral composition of the economy, characteristics of the MNEs and their investments and so on. The available empirical evidence needs to be considered in this context, at least to the extent possible, given limitations in the number of available studies. The decision to nurture specific home country effects may follow the development priorities

of the country, which are often laid out in masterplans or other key policy documents.

Another consideration is the cost and resources of required HCMs, which can vary considerably by type of measure. Information services should, for example, be cheaper and more easily implemented than the provision of loans. The potential unfavourable effects of any type of OFDI and the associated capital outflows need to be taken into account. A key consideration in developing countries will be the extent to which capital outflows may have a detrimental impact on the balance of payments. Finally, Governments may need to anticipate the political implications at home or abroad resulting from the introduction of specific HCMs. For example, acquisitions that are supported by financial measures might be viewed with concern by the Governments of host economies worried about competitive neutrality in the bidding process. All these considerations can have a considerable impact on which combination of options might actually work for a specific country and yield the desired home country effects.

It is hoped that this menu of options will be useful for Governments of developing countries in Asia and the Pacific. As many smaller countries in the region are still in the process of introducing and enhancing their policy approaches towards OFDI, it might help to navigate an increasingly important, yet complex area of economic policymaking. ESCAP, together with the World Economic Forum and Kings College of London, has therefore further developed this menu of options into an online interactive Policy Toolkit for Maximizing OFDI. Of course, it is important that such a policy toolkit is also refined as more relevant evidence emerges over time, and Governments in Asia, the Pacific and beyond gain further experience with the utilization of HCMs to leverage OFDI for development.



## E. Discussion questions

1. How can OFDI support home country sustainable development?
2. How do home country effects differ from host country effects?
3. What is the size of your country's OFDI? How internationalized is your country through OFDI (OFDI/GDP)?
4. What mechanisms and policies are in place and/or needed for OFDI to provide developmental benefits to the home economy?
5. How can OFDI home country effects also support host country effects?
6. Does your country target any home country effects?
7. What affects the strength of the OFDI home country effect?
8. How can OFDI home country effects also support host country effects?
9. Does your country target any home country effects?
10. What are home country measures to support OFDI?
11. What are the institutional arrangements for OFDI in your country?
12. Does your country make use of any home country measures to support OFDI?
13. What bottlenecks do countries face in stimulating and benefiting from OFDI?

## Part II

The policy, legal, and institutional framework for FDI: how to build an effective investment climate?

## CHAPTER



# Creating an enabling environment for FDI

## A. Introduction

As competition for FDI among developing and developed countries has intensified, the focus of investment policy has shifted towards fashioning an “enabling environment” for FDI. In addition to identifying and explaining what constitutes an enabling investment environment, this chapter also provides a brief contextual background on liberalization and privatization of FDI regimes, and introduces the concept of national competitive advantage for investment.

## B. Liberalization, privatization and FDI

The promise of FDI as an engine for economic development has gained momentum during the past 20 years. Strategies to attract FDI have also evolved during the same period. Developing countries in the 1980s were told to “get the prices right,” i.e., to eliminate micro-policies, such as energy and food subsidies, which created a gap between domestic and global prices. In the early 1990s, the new prescription proffered by the IMF was to “get the policies right”; developing countries should embrace market-oriented macro-economic 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.

Investment liberalization has continued to be an important policy tool for correcting economic distortions and improving the efficiency of economic and investment transactions. It sends a message 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 pressure from international organizations such as the International Monetary Fund 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 became more confident that they could maximize the benefits of FDI and minimize the costs (UNCTAD, 1994). Kobrin also noted that the motivation for liberalization was related to country size (smaller countries have less recourse to domestic engines of growth), the level of development (higher development levels allow 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:<sup>1</sup>

- 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; and trade balancing requirements;
- Import restrictions.

Free trade agreements, international investment agreements and WTO agreements have all contributed to investment liberalization, apart from unilateral liberalization initiatives prompted by both internal and external considerations.

The question of when, under what circumstances and to what extent it makes sense to reduce or abolish individual measures, i.e., to liberalize, cannot be answered so sweepingly. This is highly dependent on country-specific circumstances and the wider economic policy context within which FDI is embedded.

When the Global Financial Crisis broke out in 2008 and early 2009, Governments around the globe rallied to avoid protectionism and beggar thy-neighbour policies as that would lead to a further deepening of the crisis (Siles-Brügge 2014). During the past couple of years, and exacerbated by the COVID-19 pandemic, there has been a tendency to implement more restrictive policy measures due to national security (health) reasons (UNCTAD/OED, 2020). Together, COVID-19 and the wider ‘gridlock’ in global governance and the international investment regime in particular, i.e., the retreat from multilateralism (St John, 2017; Held and others, 2013; Van den Bossche, 2019), have together been responsible for a considerable uptick in more restrictive investment measures being introduced nationally across the world. Illustrating the extent to which COVID-19 has exacerbated the situation, in 2019 eight new restrictive investment measures were implemented in the Asia and Pacific region compared to 14 implemented in 2020 (ESCAP, 2021).

## 1. FDI in the context of economic, trade and financial liberalization

There is evidence that, in the 1990s and 2000s, investment liberalization was increasingly competitive among countries in their efforts to attract FDI (Cooray and others, 2014). Today, competition among countries (at similar levels of development) relates much more to (financial or fiscal) incentives. While there are many studies that evaluate 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) cites various studies that show a positive impact of trade liberalization on economic growth (which, in turn, acts as a determinant for FDI),<sup>2</sup> while few show the opposite. More recently, Yameogo and Omojolaibi

<sup>1</sup> See, for example, <http://cuts-international.org/CCIER-3-2003.pdf>

<sup>2</sup> 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 example, 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.

(2021) found trade and FDI liberalisation to be conducive to long-term economic growth, while institutional quality appeared to reduce growth in the short term in sub-Saharan Africa. Masharu and Nasir (2018) found that FDI liberalization in India resulted in diversification and sustainable development, particularly in one of the Indian economy's most important pillars, the retail sector. This entanglement is the result of FDI originating from market- or efficiency-seeking firms and countries engaged in trade, financing or other economic endeavours (for a discussion of the interplay see chapter 2). FDI is therefore embedded in wider economic processes, and liberalization needs to be viewed in, and considered against this very context (ESCAP, 2021).

It is important to be clear on what investment restrictions and liberalization ought to do for an economy. Keeping certain restrictions in place can mean efficiency and growth. For example, some East Asian economies have employed a combination of a more welcoming attitude towards FDI, coupled with strong state regulation and an overall export-oriented policy outlook (Lin and Chang, 2009; Chang, 2011). This was labelled the “Asian Miracle” of economic growth (see Krugman, 1994a and Güven, 2018). Regulations that ensured factors of comparative advantage (present or future) were complemented

and channelled into the export-led policy paradigm, contributed to an efficient concentration of industrial capacity and, thereby, exports leading to historically unprecedented growth (Chang, 2011).

Another more recent example of maintaining some control over FDI for the sake of efficiency and growth are related to Canadian digital economy regulations. Trade liberalization and competition have helped to eliminate the ‘weakest tail’ of firms, while the fastest-growing and most promising firms, the ‘gazelles’, have become the most likely candidates for foreign M&A takeovers. These takeovers have, in many instances, led to the repatriation of R&D units abroad, i.e., in the home economies of the investing firm or in other host economies. Consequently, regulations on digital economy FDI M&As have become necessary in the Canadian context, in order to prevent the country from being left with the ‘mediocre middle’ firms operating in the sector (Ciuriak, 2018).

Liberalization regulations need to be employed in a controlled and sustainable manner. Stiglitz (2000) argued that financial and capital market liberalization without the presence of an effective regulatory framework was at the core of the Asian 1997 financial crisis. The 2008 economic crisis has also been blamed on unsustainable financial liberalization



#### Box 4.1

#### Liberalization in China

China liberalized its investment regime substantially in order to meet its WTO membership. Nonetheless, the Government 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 that interfere with the efficient forces of a market economy. To overcome this problem, China implemented the Foreign Investment Law (FIL) on 1 January 2020. The new law no longer required overseas investors to go through the central Governmental approval process.

Furthermore, in an attempt to further diversify and expand investment flows, China introduced the Special Administrative Measures on Access to Foreign Investment (2019 edition), the Free Trade Zone Special Administrative Measures on Access to Foreign Investment (2019 edition), and the Catalogue of Encouraged Industries for Foreign Investment, 2019. These catalogues, which identify industries where FDI will be welcomed and treated with favourable policies, further liberalized market access in China by adding various new industries to the negative list as well as further revising previously listed ones. Among others, Beijing also relaxed and streamlined exchange control over cross-border investment, and introduced measures to open further China's financial sector to foreign capital, e.g., by removing equity cap restrictions, albeit the fact that the opening of the financial sector remains incomplete. During the COVID-19 pandemic, China has issued relief policies and measures to stabilize foreign investment, including the provision of “end-to-end” services to large-scale, foreign-invested projects under construction to guarantee completion as planned. Chinese authorities have also continued to cut the number of restrictive measures for foreign investors at the national level by 17.5% and by 18.9% for Free Trade Zones.

Source: ESCAP, 2020.

and deregulation in the United States (Crotty, 2009).<sup>3</sup> Liberalization is necessary to ensure the efficiency of markets, while regulation is necessary to ensure their stability. In addition, liberalization and regulation need not apply to the same areas. For example, 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 that 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 attracting FDI for obvious reasons. Stringent ownership as well as sector restrictions and performance requirements are clearly a disincentive for FDI. However, if countries have other attractions, such as a growing domestic middle class, advantageous geographic location or high levels of human capital that enable foreign investors to generate a return on investment despite the relatively high level of overall economic repression (Ruzmetov and others, 2021), investors may still consider investing, especially if the country is large. Smaller countries may have limitations in overall attraction of FDI and may be under more pressure to liberalize. Illustrating this, Singapore is a small country with a very liberal investment regime and high dependence on FDI for economic growth compared to China, which is a large country with a moderately liberal investment regime but a 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 relatively low (though rising) levels of FDI inflows, when compared to China (about a third of China's inflows in 2019).

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). Liberalization and regulation are dynamic, and should be constantly

reviewed and adjusted vis-à-vis growth rates and other indicators reflecting the success of economic development and agreed-upon policy strategies.

## 2. FDI and privatization

Privatization is one important aspect of economic liberalization. Privatization assumed great importance in transition economies in the 1990s and early 2000s, and is still an important modality for reducing state interference in the economy or addressing budget deficits. In particular, privatization through FDI has played an important role in China, India and countries in Central Asia (Mukherjee and Suetrong, 2009; Chakraborty, 2019; Shiyong, 2013).

Boubakri and others (2009) identified various channels for the interrelationship between privatization and FDI: (a) privatization improves the investment climate (less government, more private sector); (b) privatization leads to economic growth (the private sector is more efficient than the Government); and privatization, through share issuance, 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 issuance, while FDI is important for privatization. They also found a strong two-way causality between privatization and greenfield FDI. FDI is considered an attractive modality to dispose of state assets, particularly in cases where the domestic enterprise sector would not have the ability or willingness to buy these assets. It is especially 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 can 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, subways etc., for example through build-own-operate (BOO) and build-operate-transfer (BOT) arrangements. Nonetheless, its success depends on the quality of the domestic regulatory framework (Kirkpatrick and others, 2006; Yurdakul and Kamasak, 2021).

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

<sup>3</sup> 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>. However, this observation is not universally shared. Some have demonstrated that the number of financial restrictions actually increased between 1999 and 2008. See, for example, <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.

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).<sup>4</sup> 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 a lack – or a limited choice – of goods and services, and face

higher prices due to the lack of competition (Kirkpatrick, 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.



### Box 4.2

#### Early privatization problems in Kazakhstan involving FDI

By the end of 2015, Kazakhstan announced its Comprehensive Privatization Plan with an ambitious target of reducing the Government’s share in the economy to 15% by 2020. Given that state assets represented 40% of Kazakhstan’s GDP in 2016, privatization was expected to create a need for billions of United States dollars in FDI. A total of 806 companies in the oil and gas, transportation, and nuclear sectors were included in the plan; by the end of 2020, 506 had been sold and 301 were reorganized or liquidated.

The decision to privatize was driven by political and economic factors – the country’s export-driven, crashing commodity prices and extreme currency volatility. Privatization was also strategically undertaken to reduce state regulation of business, foster the country’s investment climate and, ultimately, increase the efficiency of Kazakhstan’s economy.

For Kazakhstan, the topic of privatization is hardly a new one. Initiatives to involve private parties in the Kazakhstani economy have been a common feature since the country gained its independence in 1991. To that extent, the two most prominent “waves” took place in the 1990s and, more briefly, between 2012 and 2014:

The first process of privatization of state property occurred in the 1990s after Kazakhstan obtained independence following the break-up of the Soviet Union, where private property was almost non-existent. Most of Kazakhstan’s large industrial enterprises were privatized, with foreign interests and private property being the buyers or joint venture partners in most cases. In all, 70% of all enterprises were sold into private hands, raising about US\$263 million for the State treasury. However, Kazakhstan’s process was criticized as being non-transparent, corrupt and socially unfair. The involvement of foreigners around national assets was not popular with a public raised in an atmosphere of hostility to foreign capitalists. By transferring management rights for key industrial enterprises to opaque offshores, the 1990s privatization drive also created a class of wealthy oligarchs and a Kazakh political elite.

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, 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.

The second wave of concerns came in 2011 when the Government of Kazakhstan adopted a “People’s IPO” policy, aimed at providing the citizens with the ability to buy shares in the country’s major enterprises and reduce the share of state-owned or controlled entities. Ultimately, despite a declared intent to generate US\$100 million to US\$200 million in investment from Kazakh citizens, the programme only managed to secure 10% equity stakes in two companies, and the share of state ownership and participation in the economy remains substantial. The failure of this programme was the result of a combination of factors – limited domestic investment capital, circumspect foreign investors reluctant to prop up bloated and debt-laden public companies, and recently nationalized pension funds that were simultaneously increasing the state’s involvement in the economy. Even with all these failed intents, Kazakhstan remains determined to carry out its state assets privatization campaign.

As a result, Kazakhstan’s most recent privatization has undeniably been an ambitious move, and one that speaks highly of the intent of the country to modernize and integrate into the global economy. The Government has made good faith efforts to engage with foreign business partners and to institute pro-business reforms aimed at easing the regulatory environment. However, continued privatization efforts will be hampered by complex problems that the Government will be obliged to adequately address. While some of these issues, such as its dependence on oil and the political relationship with the Russian Federation, are ingrained and even systemic, the country has shown that it has at least been willing to address them.

Source: Lee, 2020.

<sup>4</sup> However, this does not only apply to SOE. Firms of critical size or supplying critical infrastructure (both as perceived) are increasingly subjects of national security and sovereignty concerns (UNCTAD, 2021).

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 if the privatized enterprise operates in a competitive environment. Box 4.2 shows the problems encountered in Kazakhstan in the early reform process including privatization. Table 4.1 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 4.1 for a more comprehensive explanation. See also Tetteh (2013).



**Table  
4.1**

**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.

## C. National competitiveness and the need for an enabling environment for FDI

### 1. Linking FDI to national competitiveness

The attractiveness of a country/locality as an investment destination depends on its general development level. 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, MNEs look for countries that offer the best facilities for the least cost. Using Michael Porter's analytical model of determining national competitive advantages (figure 4.1), 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).<sup>5</sup>

- (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 refer to human resources, physical and natural resources, climate, location, unskilled labour and capital as well as modern infrastructure, universities and highly-skilled labour. Countries with a relatively large pool of advanced factors, 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 in order to tap resources in other countries where these factors (usually those that are fixed) are relatively abundant. Not only is the availability of certain factors important, but also their costs. However, while traditionally FDI has been motivated by low costs and, hence, cheap labour availability, increasingly the quality and skills of labour also matter in many 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, the availability of roads, airports, information and communications technology (ICT) infrastructure as well as the digital literacy and digital human capital of a country figure prominently in the selection of localities by MNEs.
- (b) **Demand conditions** – refers to the nature and size of home demand for an industry's product or service. This component is of particular relevance

<sup>5</sup> 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 with each other along with two additional factors affecting the other four consisting of government and chance events that are out of the 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.

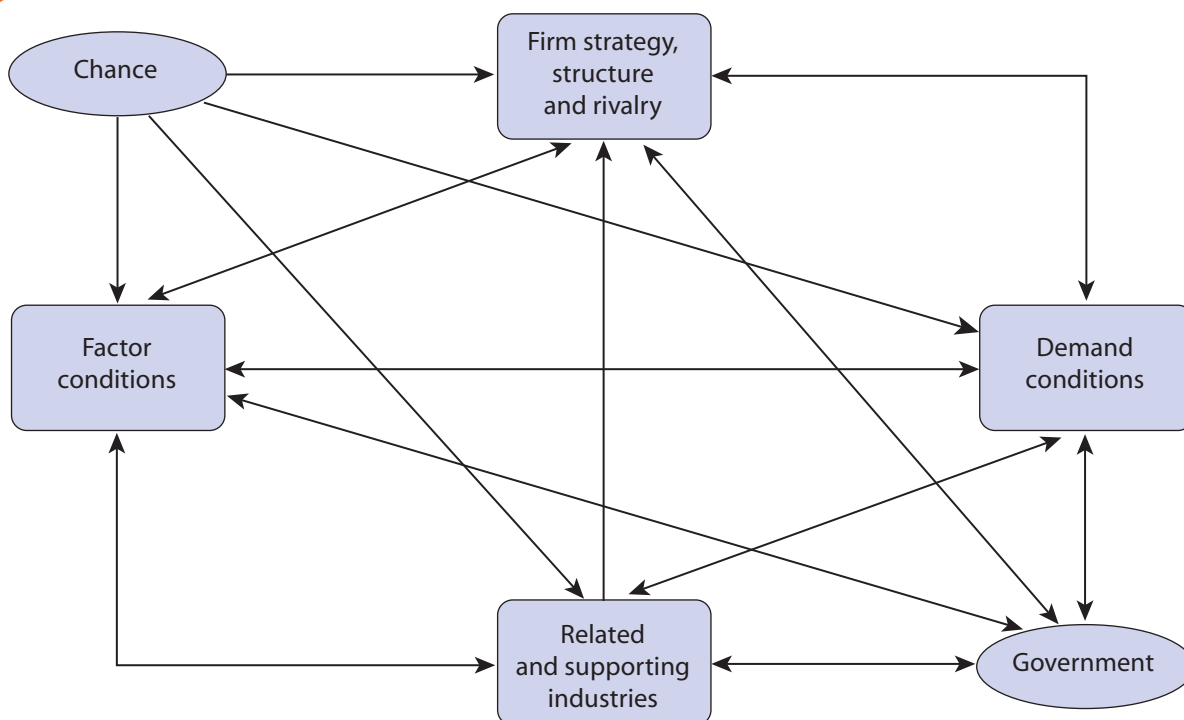


to market-seeking FDI. It is not only the size of home demand that affects competitive advantage, but also the composition of demand. Nations gain competitive advantage in industries or industry segments where the home demand gives local firms a clearer or earlier picture of buyer needs than foreign 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 advantage in a particular industry and, therefore, by selected companies in that industry, which are often the more experienced MNEs. 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 MNEs, 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 that is domestic-market oriented. Countries such as India and China are cases in point, where rising levels of income offer enormous potential for MNEs.

(c) **Related and supporting industries** – the presence or absence 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 attract related and supporting enterprises, in particular in services and supplier industries, abroad. The more that 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 drawcard for efficiency-seeking FDI and important in the context of integrating into GVCs. MNEs 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 MNEs 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 MNEs. Therefore, the

**Figure 4.1**

**Michael Porter's "diamond" of determinants of national competitive advantage**



Source: Porter, 1990 and 1998.

establishment of backward linkages between MNEs and local (often small and medium-sized) enterprises is an important development tool.

- (d) **Firm strategy, structure and rivalry** – this refers to the context in which firms are created, organized and managed as well as the nature of domestic rivalry. This determinant refers to the unique corporate culture in a particular country and the ways firms are organized in industries, which can vary widely across countries. 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.

A good level of development and the presence of all four determinants can make a country an attractive home and host country for FDI. Governments can influence each of the four determinants through policies that can subsequently develop both their national competitive advantages for FDI and level of development.

Since Porter's original diamond model was released, several attempts to expand the model have been undertaken (Cho and Moon, 2005; Rugman, 1991; Moon, Rugman and Verbeke, 1998; Dunning, 2003). This has resulted in the diamond model being extended to include incorporation of the multinational activities and the role of human factors, including workers, politicians, entrepreneurs and professionals (see Cho and Moon, 2005, for further elaboration on these extensions to the original model).

At a broad level, while all of the factors may in fact build national competitiveness, national competitiveness will also affect all of those factors when it is built. Therefore, when considering Porter's original model as well as the extension, it is important to remember that the factors within these models can mutually reinforce each other and make a country a more attractive location for FDI as well as an emerging source of it.

## 2. What constitutes a good investment and business climate?<sup>6</sup>

As competition for FDI among both developing and developed countries has intensified, fostering an enabling environment for FDI has become more important. This refers to the legal, regulatory and political institutions that 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 MNEs (OECD,

2002; Rajan, 2004). Countries with enabling environments have been more successful in attracting FDI, although often with high attendant social and environmental costs. However, most developing countries, especially 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, in fact FDI itself can help to foster sustainable development and nurture local conditions and capacities – productive, social, regulatory and institutional.

Investment climate can be understood as “the location-specific factors that shape the opportunities and incentives for firms to invest productively, create jobs and expand” (World Bank, 2004). The goal of investment policies should be to improve the investment climate by addressing the barriers faced by investors and reducing their risks. Some of the most salient barriers include: (a) high risks associated with policy uncertainty, stringent regulations, macro-economic instability, and overall lack of security from crime and potential natural disasters; (b) high costs of doing business; (c) skill level of the workforce; and (d) poor infrastructure. Indeed, each of these barriers is also addressed in the determinants of Porter's national competitiveness model.

The policy implications are evident, i.e., reduce risks and costs, and improve skills and infrastructure. The latter two aspects are related to improving factor conditions and require a longer time frame; the former two 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 in order to ensure that FDI contributes to sustainable development. For example, while investors favour policy stability, Governments should regularly monitor and evaluate the policies and measures they implement to attract investment in order to ensure they are not only contributing to a higher volume of FDI, but also to their development needs and priorities. A good investment policy addresses these issues and strives to achieve the right balance of interests of all stakeholders; it is also aligned with other relevant national (development) policies.

Barriers faced by investors can be categorized into those faced in the pre-establishment phase and post-establishment phase. In the pre-establishment phase, investors have problems evaluating sites and/or

<sup>6</sup> This is what the WTO often refers to as “investment facilitation”. The aspect of investment facilitation and promotion as well as the work of the WTO in this respect is discussed in part III. See <http://www.intracen.org/itc/Investment-Facilitation-for-Development/>


**Box  
4.3**
**Importance of an enabling business environment: Predictability, accountability and transparency**

While all determinants play a role to varying 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 they 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, the following 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 make 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 diversion of investments.
- **Accountability:** To prevent corruption and ensure 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 as well as mechanisms for inspecting 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, while simultaneously reducing the risk of corruption.
- **Transparency:** Availability of relevant laws and regulations in English is important to enabling investors to evaluate their potential investment locations. Similarly, the availability of English language websites (or any language other than the national language) helps foreign investors to navigate the new investment location. Greater openness and open information disclosure through media and information technology 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 policymakers, 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 a 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 Governments and businesses through meaningful public-private sector dialogues contribute to the legitimacy and effectiveness of policies, laws and regulations.

obtaining an investment licences 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 licences, and ensuring proper cooperation from local authorities – and starting actual operations

(erratic labour regulations, customs clearance issues, a 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 part III of this Handbook).

Improvements of investment climate needs should occur incrementally and sequentially so as to ensure its sustainability. Various countries in the region have consistently strived towards improving the investment climate; in general, progress has been made, although it remains a work in progress in most cases (box 4.4).

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 and the industry it operates in, or host country society's point of view. Investors ideally want:

- (a) Low or zero taxes, maximum labour flexibility and low wages, freedom to import and export without duties or taxes; and

- (b) Protection from competition, free repatriation of profits, no requirements for work permits for overseas workers and their families, no restrictions on ownership of property of land, strong intellectual property rights protection, rule of law, reliable dispute settlement systems, i.e., a reliable and corruption-free local court system etc.

Investors do not like regulation of their businesses, but they appreciate regulation that ensures security and stability of markets and property rights, among others. They also appreciate a pro-active IPA that not only promotes investment but also provides comprehensive aftercare services.

From a 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



#### A conducive investment climate – Singapore

Singapore has placed much emphasis on the role of FDI in its development and has evolved as an investment hub in ASEAN (OECD-UNIDO, 2019). Although the Government of Singapore 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 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 subjected 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 example, 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](http://www.reach.gov.sg) – to solicit feedback on selected draft legislation and regulations. Singapore's prescribed accounting standards – Financial Reporting Standards (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. Available at <http://www.state.gov/documents/organization/241949.pdf>

benefits to society in terms of economic and social development with minimum negative environmental externalities on the other hand. After all, FDI is not attractive 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 keys to achieving this delicate balance. The legal framework for FDI is further discussed in chapter 5.

### 3. Moving beyond the ease of doing business era

Investors often refer to global rankings and assessments to get a sense of how open a given country is to investment. In the past, the World Bank's East of Doing Business report was widely used; however, in view of the recent problems related to the methodology of the rankings, investors

and policymakers are turning to other assessments. A non-exhaustive list of various assessments conducted by public and private analytical agencies and organizations is provided in table 4.2, each of which uses different methodologies. Indeed, there is no universal methodology for ranking countries in terms of competitiveness due to the unequal distribution of resources in the world (Dzhukha and others, 2017). Furthermore, rankings can be misleading if they are not based on a rigorous model using an appropriate methodology (see Cho and Moon, 2005 for more information). Finally, it should be noted that competitiveness reports are, by nature, highly political; therefore policymakers should be careful when using them to inform policy development, as they can also result in the pursuit of undesirable policies for countries as a whole, as they are often sensitive to the results of reports of this type and can be misled to pursue undesirable policies.



**List of public and private institutions publishing competitive rankings of countries and indices**

Institution	Rankings/Indices
ATKearney	Global Cities Index (2008)
Cable.co.uk	Worldwide Broadband Pricing League Table (Cable.co.uk provides a broadband ranking and interactive map, comprising 211 countries).
Coface	Country and Sector Risk
Control Risks	Risk Maps (Control Risk provides a map with a Security Risk forecast indication and Political Risk forecast indication). Furthermore, they provide cybe-, maritime- and region-specific risk maps. Available at <a href="https://www.controlrisks.com/riskmap/maps">https://www.controlrisks.com/riskmap/maps</a> )
Economist Intelligence Unit	Global Food Security Index (2012) Democracy Index (2006) Liveability Index (2002) Cost of Living City Rankings
EF Education First	EF English Proficiency index (2011)
ETH Zurich	Kof Globalization Index (2002)
Euler Hermes	Country and Sector Risk
Ewing Marion Kauffman Foundation	Kauffman Indicators of Entrepreneurship
Forbes	Best Countries for Doing Business
Gallup	Global Emotion Report (2012) Law and Order Index
Good Country	The Good Country Index
Global Entrepreneurship and Development Institute	Global Entrepreneurship Index (2014)
INRIX	Global Traffic Scorecard
INSEAD	Global Talent Competitiveness Index (2014)
Institute for Management Development	World Competitiveness Index (1989)
JLL	City Momentum Index (2013) Global 300 Cities Index

**Table 4.2** (continued)

Institution	Rankings/Indices
Legatum Institute	Legatum Prosperity Index (2007)
OAG	Mega hubs Connectivity Index
Open Knowledge Foundation	Global Open Data Index
Social Progress Imperative	Social Progress Index (2013)
Start-up Genome	Global Start-up Ecosystem Report (2012)
Talent Solutions	Talent Workforce Index (2013)
Transparency International	Corruption Perception Index (1995)
United Nations	Social Development Goals Index (2015) E-Government Development Index (2003) World Happiness Index (2012)
United Nations Conference on Trade and Development (UNCTAD)	World Investment Report (1991)
United Nations Development Programme (UNDP)	Human Development Index (1990)
United Nations International Telecommunication Union	ICT Development Index (2009)
World Bank Group	Digital Adaption Index (2014) Logistics Performance Index (2007) Doing Business (2003) Worldwide Governance Indicators (2002)
World Economic Forum	Global Energy Architecture Performance Index (2018) Global Enabling Trade Index (2008) Travel and Tourism Competitiveness Index (2007) Global Competitiveness Report (2004) Global Information Technology Report (2001)
World Intellectual Property Organization	Global Innovation Index (2007)
Yale University and Columbia University	Environmental Performance Index (2002)

Source: van den Berghe, 2018.

Note: Year in parenthesis (if available) shows the first publication of report/ranking.

Technical assistance on private sector development and improvements in the investment climate are provided by various multilateral agencies, including ESCAP, OECD, UNCTAD and the World Bank Group. FDI policies are also covered in the regular WTO Trade Policy Reviews. Box 4.5 describes the services provided by the World Bank/Facility for Investment Climate Advisory Services (FIAS), previously known as Foreign Investment Advisory Services, and OECD.

Overall, even countries with relatively good investment climates and 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. Given the issues with competitiveness assessments and investment climate rankings, investors and policy-makers would benefit from a deeper understanding of the modalities for investment promotion and facilitation, to which this Handbook aims to contribute in Part III.



### 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 and Competitiveness Global Practice (T&C), which is a joint service provided together 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 35 years and was previously known as the World Bank's Foreign Investment Advisory Services. FIAS currently 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. FIAS-supported work is organized into three strategic pillars: (a) improving the business environment in client countries; (b) expanding market opportunities; and (c) strengthening firm competitiveness. According to its 2019 Annual Review, through the first three years of the five-year FY17-21 strategy cycle, FIAS has helped bring about 133 investment climate reforms in 55 client countries, less than the three-year target of 165 reforms for the 2017-2019 period. FIAS has currently been focusing on supporting development in countries affected by fragility, conflict and violence (FCV). The experience and lessons learnt through these supported projects will prove valuable as more client countries grapple with extreme conditions brought on by the pandemic crisis. These programmes are explained in more detail in the 2019 *FIAS Annual Review* (World Bank, 2020).

Outside FIAS, the World Bank undertakes periodic Investment Policy and Regulatory Reviews (IPRRs) at the national level. Most recent reports issued in 2020 assessed the legal and regulatory frameworks governing FDI and the investment climate in China, Indonesia, Malaysia, Thailand and Viet Nam.

The OECD Investment Policy Reviews are conducted using the OECD investment instrument and – since its adoption in 2006 – the OECD's Policy Framework for Investment. 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 region were conducted for Cambodia (2018), China (2008), India (2009), Indonesia (2020), Kazakhstan (2017), the Lao People's Democratic Republic (2017), Malaysia (2013), Myanmar (2020), the Philippines (2016), Russian Federation (2008), Thailand (2021) and Viet Nam (2018). Typically, when the OECD works with countries on investment policy review, it includes a taskforce of 20+ government agencies as well as stakeholders from international organizations, the private sector, civil society and academia.

## D. National competitive advantages and FDI: A two-way street

As discussed in section B of this chapter, countries with strong national competitive advantages are better able to attract FDI. However, countries can use FDI to strengthen and expand advantages. FDI can also play an important role in shaping a country's competitive advantage.

Porter (1990, 1998) identified various stages of development in which FDI can play a role in helping a country to develop and strengthen its competitive advantages. In the initial stages of developing such advantages, i.e., when the country is in the “factor-driven” stage of development, FDI is typically geared towards natural resources exploitation and labour-intensive industries. In this stage, the impacts of FDI on sustainable development can only be optimized through policies that Governments must put in place. For example, 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 to 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.



**Promoting inward FDI for strengthening national competitiveness**

Determinant of national competitive advantage	Potential contribution of FDI	Required policy intervention
Factor conditions	<p>Transfer of knowledge, technology and skills.</p> <p>Development of infrastructure (roads, ports, ICT etc.).</p>	<p>Build effective linkages through joint ventures and development of education and vocational training; proper legal framework including IPR.</p> <p>Transparent privatization process (including for build-operate-transfer) and solid regulatory framework and implementation of rule of law.</p> <p>Develop frameworks for public-private partnerships.</p>
Market conditions	<p>Provide employment at higher-than-average wages.</p> <p>Sale of higher quality (and more sustainable) products which will develop market “taste” of consumers; brand name development (made in...).</p>	<p>Ensure the labour force has the required minimum skills; establish minimum wage at realistic levels reflecting productivity; keep labour laws flexible.</p> <p>Enforce product quality and testing in conformity with international standards; apply proper regulatory framework with strong environmental provisions</p>
Related and supporting industries	<p>Leading MNEs 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.</p>	<p>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.</p>
Firm strategy, structure and rivalry	<p>MNEs can bring new management practices and ideas for structural reform. They can affect the structure of whole supply chains and, hence, domestic suppliers. MNEs also can foster competition.</p>	<p>Provide a liberal investment and business climate (avoid protection of domestic enterprises); implement strong competition policy, including competition or anti-trust regulatory framework.</p>

Source: ESCAP.

Table 4.3 summarizes some of the potential contributions that FDI can make to the four determinants of national competitive advantage under the right policy conditions. The policy suggestions in the table are non-exhaustive.

### **E. Science, technology, innovation, competitive advantages and the role of FDI**

Science, technology and innovation (STI) can play an important role in shaping national competitive advantages and in attracting FDI. Similarly, FDI can play an important role in building competitive advantages in STI. This is evident simply by observing inward FDI trends (see chapter 2); the countries that have attracted the largest shares of global FDI during the past two decades – for example, the United States, United Kingdom and

Germany – rank higher on the innovation scale. The vocational training and education systems as well as the business and policy environment supporting R&D in those countries have made them more attractive for FDI in sophisticated and technology-intensive sectors (for example, in AI or biotechnology). Much of such inward FDI is, in fact, R&D, which has the potential to stimulate skill and knowledge development spill-over effects (Fagerberg and Srholec, 2008).

Innovation and technology development can 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 SDG and has a cross-cutting role to play in addressing the interconnected challenges of sustainable development and providing effective solutions (Chaisse, 2016).



The dramatic acceleration of digitalization (see chapter 1), particularly since the start of the COVID-19 pandemic, combined with the Fourth Industrial Revolution (Industry 4.0; see box 4.6), have emphasized the need for appropriate and effective STI policies that can help countries to build competitive advantages in the most relevant sectors for their economies. In designing and implementing an STI policy environment, policymakers should

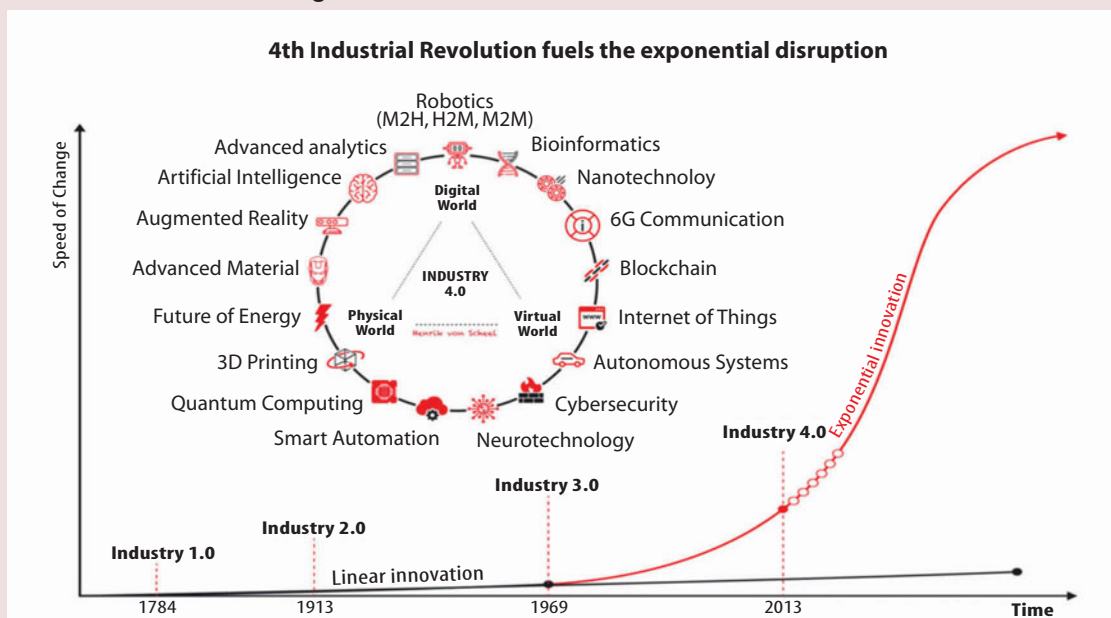
include a specific role for FDI. For example (as highlighted in chapter 1), FDI should be included as an important means of financing digitalization. It can enrich digital infrastructure, provide new employment opportunities that help to build digital literacy and skills, and it can also encourage the development of a local ecosystem that supports digital business growth.



**Industry 4.0**

Industry 4.0 is fundamentally altering every aspect of the way we live and work, and how our economies can sustainably and inclusively develop and grow. The scale, scope and complexity of these shifts are unlike anything humankind has previously experienced, and they are already disrupting every industry and economy in the world (figure A).

**Figure A. Four waves of Industrial Revolutions**



Source: Henrik von Scheel, 2018.

Industry 4.0 is the fourth in a series of Industrial Revolutions, which are characterized by their ability to transform economies, jobs and even society itself through the introduction of new technologies and processes. There are multiple definitions of Industry 4.0, but all mention the change it entails, and that at its core is the marriage of physical and digital technologies such as analytics, artificial intelligence, cognitive technologies and the Internet of Things (IoT). This marriage of the physical with the digital allows the creation of a digital enterprise with data collected from physical systems being used to drive intelligent action back in the physical world. Industry 4.0 generates abundant opportunities for new products and services, better ways to serve customers, new types of jobs and wholly new business models. As in the previous Industrial Revolutions, the impact of these changes has the potential to cross industries, businesses and communities, affecting not just how we work, but also how we live and relate to one another. The difference to previous industrial revolutions is that it is advancing at extraordinary speed, driven by technologies developing at an exponential rate (Deloitte, 2020).

Sources: Taylor-Strauss, H., van den Berghe, D. and H. von Scheel, 2021.

Below is a non-exhaustive list of policy priorities that Governments should consider for promoting STI. While they are identified separately they are, in fact, heavily interlinked (OECD, 1997 and 1999; Feinson, 2003; Kaiser and Prange, 2003; Lundvall and others, 2006; Fagerberg and Shrolec, 2008; Naudé, 2017; Gleason, 2018):

- **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. Open trade and investment regimes may also increase the level of competition that, in turn, will foster innovation. This is the basic idea underlying all subsequent points;
- **Education and investment in human capital:** Not only is primary and secondary education important here; 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 example, in Malaysia, where four anchor investors committed equipment and executive teachers to the fledgling Penang Skills Development Corporation (Freund and Moran, 2017).<sup>7</sup> Research of selected African economies has also shown that FDI has a particularly strong effect on tertiary education, which is needed to advance in technology sectors (Kaulihowa and Adjasi 2019);
- **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. FDI can play a major role in establishing and developing clusters, while the resulting trade flows, if permitted, have positive effects on innovation (Yildirim and Arun, 2019);
- **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 commercial application. National capabilities to undertake R&D and develop new technologies are the key to developing national competitive advantages and are a big attraction for MNEs. For example, the development of India’s capabilities in the area of ICT has drawn major global MNEs in the ICT industry to India;
- **Establishment of world-class metrology, standards, testing, and quality control (MSTQ) infrastructure:** This is to ensure that the quality of domestic industrial products meets international standards which, in turn, grants investors the necessary confidence to choose a particular country or zone;
- **Nurture innovation and entrepreneurship culture:** 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, firms generally have stronger incentive to engage in innovation if they operate in a fiercely competitive environment. 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 for international investors looking 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

<sup>7</sup> As reported in Freund and 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 PSDC as one of the 10 leading Workforce Development Institutions in the world.”

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;

- **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; however, it 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 enabling infrastructure:** Governments can provide the physical infrastructure for clusters and networks such as incubation parks, science and technology or high-tech parks etc.;
- **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 at 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. Such SMEs would be promising partners of MNEs in technology-intensive supply chains;
- **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, and 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.

## F. Discussion questions

1. In what way is liberalization and privatization important for stimulating FDI?
2. Why does your country attract FDI? In other words, what are the immediate and long-term objectives of attracting FDI?
3. Has your country undertaken any economic, financial, trade and investment liberalization initiatives? How have these initiatives helped economic growth and attraction of FDI?
4. 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?
5. How is Porter's Diamond relevant to FDI?
6. What are competitive advantages? How can you build them? What role does FDI play?
7. What are your country's competitive advantages?
8. Does your country have an STI policy?
9. What policy priorities should a country consider when developing an STI agenda? How can FDI play a role?

## CHAPTER



# Institutional, Policy and legal frameworks for sustainable FDI

## 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, such as in Sri Lanka, there is a Ministry of Investment Promotion, although principal investment policy is set by the Ministry of Economic Development. In the Greater Mekong Subregion (GMS) countries such as the Lao People's Democratic Republic and Viet Nam, investment policy is determined by the Ministry of Planning and Investment. However, other ministries may determine investment policy in their respective areas, i.e., transport, ICT, mining and energy. In addition, the Ministry of Labour and Ministry of Environment are always involved with regard to labour issues and environmental screening of investment projects, while the Ministry of the Interior or Ministry of Land deals with land access issues and the Ministry of Tourism deals 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 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 the Government, 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 with bodies that are directly involved in formulating investment policy, but also with bodies that set policies that affect investment in particular (i.e., trade and finance), as increasingly free trade agreements have investment and finance chapters and/or provisions. Last, 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 that are not always in line with central government policy set by the Ministry of Planning and Investment in Hanoi.

Investment policy is usually separated from investment promotion (see boxes 5.1 and 5.2 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 an 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. Most successful IPAs do 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) (Daniel and Forneris, 2010). 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 should be undertaken by a responsible line ministry rather than by the IPA. Where the two functions are combined in one agency they can still be separated (Griffin and others, 2011). A good example of an IPA focusing on investment regulation is provided by Fiji or Malaysia, for example, in which cases of policy implementation lies with the Ministry while the IPA adjusts the regulatory environment (table 5.2). Table 5.1 lists the divergent needs of investment promotion and investment regulation.



**Table 5.1 Divergent needs between the promotion and regulation of FDI**

Institutional dimension	Investment promotion	Investment regulation
Organizational culture	<ul style="list-style-type: none"> <li>Customer-oriented;</li> <li>Private sector focus and mentality;</li> <li>Concerned with priority industries.</li> </ul>	<ul style="list-style-type: none"> <li>Compliance-oriented;</li> <li>Administrative focus;</li> <li>Concerned with all FDI.</li> </ul>
Staff skills	<ul style="list-style-type: none"> <li>Marketing and sales;</li> <li>Project and customer relation management;</li> <li>Communications.</li> </ul>	<ul style="list-style-type: none"> <li>Administration;</li> <li>Legal and financial issues;</li> <li>Precision and thoroughness.</li> </ul>
Knowledge	<ul style="list-style-type: none"> <li>Business practices;</li> <li>Sector expertise and competitiveness;</li> <li>Laws, regulations and procedures;</li> <li>FDI data;</li> <li>Foreign languages and business cultures.</li> </ul>	<ul style="list-style-type: none"> <li>Laws, regulations and procedures;</li> <li>FDI data.</li> </ul>
Enabling environment	<ul style="list-style-type: none"> <li>Flexibility within set parameters;</li> <li>Fast approvals and delegated authorities to permit rapid responses to investor needs;</li> <li>Outcome-driven.</li> </ul>	<ul style="list-style-type: none"> <li>Fixed procedures and approval mechanisms;</li> <li>Supervision and audit;</li> <li>Process-driven.</li> </ul>
Internal systems	<ul style="list-style-type: none"> <li>Tailored approaches (using defined methodologies);</li> <li>Quick, flexible responses to investor needs;</li> <li>Follow-up until an investor is satisfied.</li> </ul>	<ul style="list-style-type: none"> <li>Standardized systems;</li> <li>Investor requests are met at the speed of the system;</li> <li>Follow-up with investors only as required.</li> </ul>

Source: Griffin and others, 2011, table 1.


**Institutional arrangements and responsibilities in Asia and the Pacific<sup>1</sup>**

Countries	Investment policy institution	Main IPA	Other institutions
Afghanistan	High Commission on Investment (HCI)	Ministry of Commerce and Industry Afghanistan (MOCI)	High Economic Council (HEC)
Armenia	Ministry of Economy's Department of Investment Policy	Investment Support Center (ISC)	Private companies for investment promotion
Azerbaijan	Ministry of Economy	Azerbaijan Investment Company (AIC); Azerbaijan Export and Investment Promotion Foundation (AzPromo) (for non-oil sectors)	Azerbaijan Service and Assessment Network (ASAN) (a one-stop shop public service platform for business registrations)
Bangladesh	No specific institution or ministry, part of wider development strategies	Bangladesh Investment Development Authority (BIDA) (private)	Bangladesh Export Processing Zone Authority (BEPZA)
Cambodia	Council for the Development of Cambodia (CDC)	Cambodia Investment Board (CIB) (including application review and incentives)	Cambodian Special Economic Zone Board (CSEZB) (also application review and incentives)
China	Ministry of Commerce (MOFCOM)	China Investment Promotion Agency (CIPA)	Provincial agencies
Fiji	Ministry of Commerce, Trade, Tourism and Transport (MCTTT) (implementation and review)	Investment Fiji (regulatory unctions, promotion, advisory, finformation services, liaison between public and private as well as regional and international agencies)	
Georgia	Ministry of Economy and Sustainable Development	Invest in Georgia (Investment division of Enterprise Georgia) (moderator between foreign investors and the Government, one-stop shop for support prior, during and after the investment process)	Ministry of Economic and Sustainable Development's Enterprise Georgia
India	Ministry of Commerce and Industry's Department for Promotion of Industry and International Trade (DPIIT)	Invest India (managed by DPTIT, state governments and business chambers)	
Indonesia	Ministry of Investment	Ministry of Investment	
Kyrgyzstan	Ministry of Economy	Investment Promotion and Protection Agency (IPPA) (assisting companies, also in finding business opportunities)	Business and Entrepreneurship Development Council (coordination between business associations and government bodies, discusses investment facilitation and promotion of entrepreneurship)
Lao People's Democratic Republic	Investment Promotion Department (IPD) (under the Ministry of Planning and Investment)	Investment Promotion Department (IPD) (including one-stop shop for licensing)	

<sup>1</sup> Responsibilities that go beyond traditional competencies are noted in parentheses.

**Table 5.2** (continued)

Countries	Investment policy institution	Main IPA	Other institutions
Malaysia	Ministry of Industry and Trade (MITI)	Malaysian Investment Development Authority (MIDA) (under the MITI, regulation and promotion)	Invest Kuala Lumpur; Invest Penang, Invest Selangor; the Sabah Economic Development and Investment Authority (SEDIA); and the Sarawak Economic Development Corporation (business strategy consultations, area familiarization, talent management programmes, networking and other post-investment services)
Papua New Guinea	Investment Promotion Authority (facilitation and regulation)	Investment Promotion Authority	
Philippines	Department of Trade and Policy (DTP)	Board of Investment (BOI) (under the DTP)	Philippine Economic Zone Authority (PEZA)
Republic of Korea	Ministry of Trade, Industry and Energy (MOTIE)	Invest Korea (including one-stop service)	Korea Trade-Investment Promotion Agency (KOTRA) (including an Outbound Investment Support Office)
Sri Lanka	Ministry of Investment Promotion (MIP), Ministry of National Policies and Economic Affairs (MNPEA) and Sri Lanka Board of Investment (BOI)	Board of Investment (including one-stop services)	Ministry of Finance's Trade and Investment Policies Department (assists in inward FDI policy formulation and review of BOI and non-BOI measures) and Export Development Board (subsidies for companies seeking to establish outward operations)
Thailand	Board of Investment	Board of Investment	Ministry of Industry and Ministry of Commerce's Department of International Trade Promotion (DTIP) (responsibility for outward investment promotion and smaller markets in particular)
Viet Nam	Ministry of Planning and Investment (MPI)	Foreign Investment Agency	Provincial and local investment promotion institutions

Sources: ESCAP online research, various national IPA websites, UNCTAD and OECD Investment Policy Reviews, UNCTAD Investment Policy Hub (<https://investmentpolicy.unctad.org/investment-policy-monitor/measures/3712/indonesia-new-investment-ministry-established>) and the United States Department of States Investment Climate Statements.



Investment promotion is a distinct function that requires an agency which works directly with investors. Investors will not take such an agency seriously if it also acts as a “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, although it also performs an important marketing role. 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. Therefore IPAs also should normally not be involved in investment project screening – which is a function of regulation – although 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. However, IPAs can facilitate access for investors and are really meant to attract investors and help them realize their investment, not regulate them.

For similar reasons, IPAs are ill-equipped 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 comprehensive investment policy and promotion agencies which can only function effectively in political systems characterized by centralized policy formulation and control. Box 5.1 discusses the example of Singapore. The experience of separating investment promotion from investment regulation is provided by Hong Kong, China in box 5.2.



### FDI policy and promotion institutional framework in Singapore

As a nation that is highly dependent on international investment for economic growth, Singapore maintains a heavily trade-dependent economy characterized by a free open and liberal investment regime. The Government of Singapore is committed to maintaining a free market, and its legal framework and public policies are generally favourable toward FDI. Apart from regulatory requirements in some sectors, eligibility for various incentive schemes depends on investment proposals meeting the criteria set by relevant government agencies. The Ministry of Trade and Industry (MTI) is the main government ministry responsible for trade and FDI-linked policy.

In addition, the Government of Singapore has encouraged FDI, and continues to do so, through the implementation of various initiatives. Singapore’s Economic Development Board (EDB), a statutory board under MTI, is the lead IPA in charge of investment promotion and facilitation in Singapore with a wide range of responsibilities to assist foreign and local businesses. In particular, EDB performs the following roles (see <https://www.edb.gov.sg>):

- Undertaking investment promotion and industry development in the manufacturing and services sectors;
- Engaging local and foreign companies with international businesses to transform their operations and boost productivity;
- Providing information, connection to partners and access to government incentives for their investments.

Moreover, the Government promotes outward investment through Enterprise Singapore, another statutory board under the Ministry of Trade and Industry (MTI). It provides market information, business contacts, and financial assistance and grants for internationalizing companies.

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 (see <https://www.edb.gov.sg>).



**Box  
5.2**

### **Separating investment promotion from investment regulation: The case of Hong Kong, China**

IPAs with both promotional and regulatory functions is a controversial topic in the investment promotion literature. Some suggest that IPAs should focus exclusively on investment promotion, while others recommend that IPAs pursue multiple mandates. Many Asian IPAs combine regulatory and promotion and facilitation mandates, even if investors are often confused when dealing with agencies that both promote and regulate FDI as they prefer clarity of roles.

In most countries and economies that have succeeded in attracting significant FDI, IPAs do not typically have regulatory functions. Successful IPAs such as InvestHK carry no regulatory functions. InvestHK was established in 2000 as a government agency, independent of regulators, with a single mandate to attract and retain FDI while promoting Hong Kong, China as the leading international business hub. Its investment promotion work is set to support government policy objectives.

With an emphasis on achieving best practices to attract and retain FDI, estimated job creation from inward foreign investment in Hong Kong, China stood at more than 10,000 jobs in 2016. The number of inbound greenfield FDI projects also increased to 166 and it hit its highest inbound capital expenditure level since 2013, with nearly US\$5.3 billion.<sup>2</sup> InvestHK also has been offering proactive, one-to-one support services throughout their planning and implementation process to invest in Hong Kong. The benefits of keeping regulatory functions out of the IPA are reflected in InvestHK's nine specialist sector teams and its closeness to both the private and public sector. In addition, while InvestHK's long-term partnership with strategic enterprises helps to keep the agency attuned to the concerns and expectations of potential investors, the Director-General of Investment Promotion and his direct channel to the Secretary for Commerce and Economic Development give InvestHK the government backing it needs to support investors in the country.

*Sources:* Griffin and others, 2011; Heilbron and others, 2019.

## **B. A new generation of investment policies: Sustainable foreign direct investment**

### **1. A policy framework for sustainable foreign direct investment**

Recently there has been a shift towards the adoption of “new generation” of investment policies (UNCTAD, 2012 and 2015). These policies place inclusive growth and sustainable development at the heart of efforts to attract and benefit from FDI, and strive to attract “sustainable” FDI (Narula, 2012). Recalling from chapter 1, sustainable FDI is defined along the four dimensions of sustainable development—economic, environmental, social and good governance. 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;

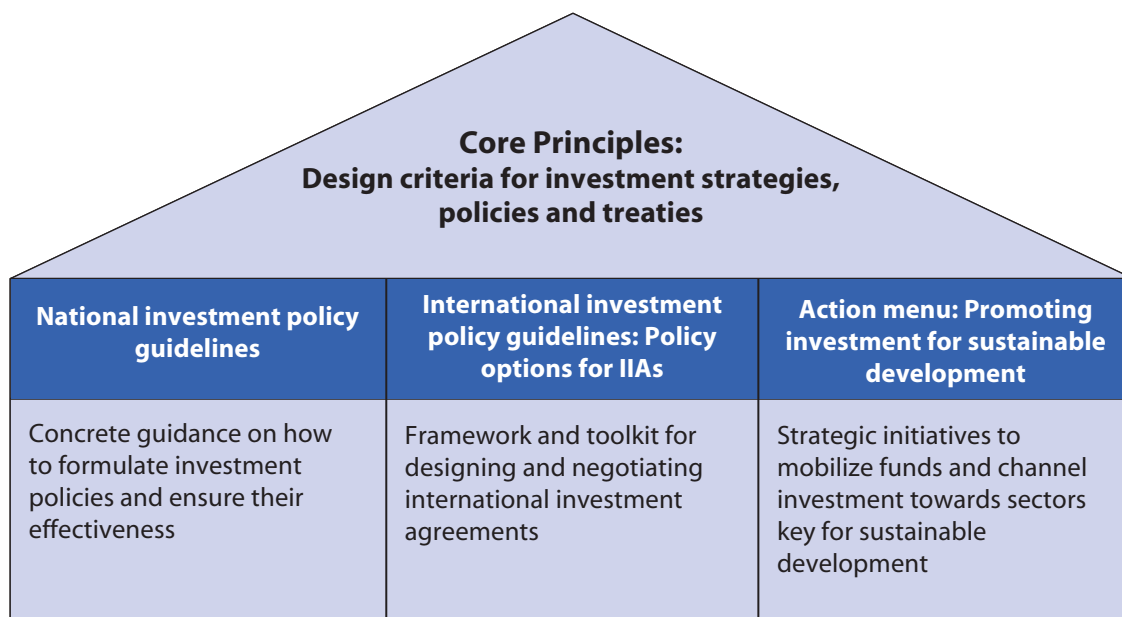
- Create synergies with wider economic development goals or industrial policies, and achieve seamless integration in development strategies;
- Foster responsible investor behaviour and responsible business conduct;
- Ensure policy effectiveness in their design and implementation and in the institutional environment within which they operate.

UNCTAD has been at the forefront of sustainable FDI promotion through its Investment Policy Framework for Sustainable Development (IPFSD) (UNCTAD, 2012 and 2015). Figure 5.1 shows the essential composition of IPFSD. Box 5.3 lists the core principles of the IPFSD.

<sup>2</sup> See <https://www.fdiintelligence.com/article/70510>



The components of UNCTAD's IPFSD



Source: UNCTAD, 2015.



**Core principles of UNCTAD's Investment Policy Framework for Sustainable Development**

The overarching objective is investment for sustainable development based on the following 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.

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

#### (a) National investment policy challenges

- (i) Integrating investment policy into development strategy:
  - Channelling 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.

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, and 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.

#### (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.

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

The Policy Framework identifies key sectors for sustainability where FDI could be attracted on a priority basis (table 5.3). A more detailed overview of the IPFSD and a list of specific national policy guidelines can be accessed at <https://investmentpolicy.unctad.org/investment-policy-framework> and the overall website for UNCTAD's investment policy tools can be accessed at <https://investmentpolicy.unctad.org/>

UNCTAD's Investment Policy Framework was followed by an Action Plan for Private Investments in the SDGs (UNCTAD, 2015). The Action Plan contains a Strategic Framework for private investment (not only FDI) in the SDGs as well as a set of guiding principles to help overcome policy dilemmas associated with increased private sector engagement in SDG sectors. The Action Plan is based on the notion that private sector contributions can take two main forms: (a) good governance in business practices and (b) 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 the Government on maximizing co-benefits of investment. The Action Plan can be accessed at [https://unctad.org/system/files/official-document/osg2015d3\\_en.pdf](https://unctad.org/system/files/official-document/osg2015d3_en.pdf)

The remainder of this section looks at the frameworks and tools that several other international organizations have developed for sustainable investment.

The OECD has longstanding interest and expertise in shaping the policy environment to enhance the societal impacts of private investment (OECD, 2002


**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 railways.
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.

and 2021a). This expertise now spans a wide range of policy areas, in the form of legal instruments, research initiatives, advisory services and stakeholder networks. It is reflected in the updated OECD Policy Framework for Investment and its 2021 implementation report (OECD, 2015a and 2021b) that serves as the basis for country-level Investment Policy Reviews. The OECD further engages in partnerships with businesses and other initiatives to help the private sector improve their social and environmental impacts, and develop standards for measuring and reporting these impacts. How FDI relates to sustainable development in different country and policy contexts, and which policy mix supports FDI-induced sustainable development gains, are still very unclear. Following a request by OECD Ministers, and in an effort to address this gap, the OECD launched the FDI Qualities initiative (OECD, 2018a and 2018b). This project is an important element of the OECD Action Plan on the SDGs (OECD, 2016) and provides practical inputs for policy discussion in high-level OECD and other international policy fora.

The OECD's work on FDI and sustainability is reflected in its FDI Qualities report which can be found in FDI Qualities Indicators: Measuring the sustainable development impacts of investment – OECD (oecd.org). The FDI Qualities initiative focuses on how the activities of foreign MNEs can contribute to the SDGs beyond the additional financing they bring; for example, when they train workers or enhance the capabilities of local suppliers.

The Roundtable on Investment and Sustainable Development (RISD) is central to OECD's efforts in relation to the SDGs (see OECD Action Plan on the Sustainable Development Goals). It aims to develop new forms of OECD engagement that support policy coherence and maximize the role of private investment as a catalyst for sustainable development. Building on the first and second RISD held in 2018 and 2019, and maintaining its flexible and inclusive nature, the third Roundtable continued policy discussions and critical thinking through the active participation of member and partner countries and a variety of non-governmental actors. Under the strategic guidance of the OECD Investment Committee, RISD seeks synergies with related initiatives in other fora, including the United Nations and its agencies, the World Bank Group, and regional development banks. Roundtable participants included senior government representatives from investment and development communities both from OECD and partner countries, international organizations, business executives, and representatives from civil society and academia.

The OECD responsible business conduct (RBC) standards provide minimum requirements for investors to operate in a way that does not hamper inclusive and sustainable development (OECD, 2011 and 2018), and many Governments encourage and enable private sector efforts to adhere to these standards through dedicated interventions. The RBC standards expect companies to contribute positively to environmental, social and economic progress,



### OECD Policy Framework for Investment

OECD released its revised Policy Framework for Investment (PFI) in 2015 (updated from its 2006 Policy Framework for Investment). The objective of the 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 that provides a checklist of key policy issues for consideration by any Government interested in creating an enabling environment for all types of investment and 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 to 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; and 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 and 2021a.

while also addressing negative repercussions of their endeavours, including their supply chain. Specific recommendations range from disclosure requirements for combating bribery to matters of taxation and beyond. National Contact Points (NCPs) are to be set-up in participating countries as a mediation platform to help resolve disputes in cases of alleged non-observance. A link to the work on responsible business conduct in Asia can be found at <http://mneguidelines.oecd.org/responsible-supply-chains-asia/>

The Group of 20 established a Trade, Investment and Industry Working Group which developed a set of guiding principles for global investment policymaking. Under the presidency of China in 2016, 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 5.5).

Finally, UNIDO initiated a platform for organizations, policymakers, and academia to engage in public-private dialogue on issues related to FDI’s contribution to inclusive and sustainable development. Scholars

of the International Institute for Sustainable Development (IISD) and the International Centre for Trade and Sustainable Development (ICTSD) developed an indicative list on the sustainability characteristics of FDI (Sauvant and Mann, 2017). In academic circles, a new strand of research examines how different types of investment have different repercussions on the domestic economy (Alfaro, 2017; Alfaro and Charlton, 2013; Farole and Winkler, 2014). A recent study by experts from various fields shows how investment could be governed in the context of challenges related to sustainable development (Aisbett, 2018).

A key challenge with each of the above frameworks is that they only address macro-level issues and are largely focused on FDI flows. For example, Kline (2012) observed that it falls short of providing an integrated and applied mechanism for assessing whether FDI meets sustainability criteria. In response to this, ESCAP has developed a set of general and sector specific indicators to complement to these frameworks. These indicators can serve as a quantitative tool that IPAs can use to evaluate the contribution of FDI projects to their country’s sustainable development priorities (ESCAP, 2021).



### The G20 Guiding Principles for Global Investment Policymaking

With the objective of (a) fostering an open, transparent and conducive global policy environment for investment, (b) promoting coherence in national and international investment policymaking and (c) 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 have an 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. Available at [https://www.wto.org/english/news\\_e/news16\\_e/dgra\\_09jul16\\_e.pdf](https://www.wto.org/english/news_e/news16_e/dgra_09jul16_e.pdf)

Table 5.4. identifies the general indicators along the four dimensions of sustainable development that can be used to evaluate the extent to which an FDI project meets certain sustainable development priorities.<sup>3</sup> These priorities can be adjusted to each national context by adjusting the thresholds. Table 5.4 identifies sample thresholds. The indicators apply a multiple binary scoring strategy to a project for each indicator given. From this, a total score can then be given for a project. Countries can set a scale where only projects that receive a score above a certain level can be considered for approval, as they contribute to sustainable development. Those below

that level could, for example, be sent back to the potential investor for revision. Countries could even take this methodology a step further and consider offering special incentives to investment projects that meet the minimum score of qualifying as sustainable development projects. For these indicators to be most effective it is essential that IPAs transparently convey to investors that they will be used and indicate what thresholds will be applied to evaluate each project. A full description of the methodology and explanation of how to implement it practically is given in table 5.4.



**Table 5.4** General Sustainable FDI Indicators

Sustainable Development Dimension	Indicators	Threshold	Definition
Economic	Job creation	(0) Less than three jobs created for every million US dollars of capital expenditure. (2) More than three jobs created for every million US dollars of capital expenditure	Number of jobs created.
	Capital investment	(0) FDI inflows minus capital and profit repatriation is positive in the first three years. (1) FDI inflows minus capital and profit repatriation is positive between year 3-5. (2) FDI inflows minus capital and profit repatriation is positive after five years	FDI inflows minus capital and profit.
	Direct payments	(0) Direct payment over a three-year period is less than 5% of total cost of the FDI project. (2) Direct payment over a three-year period is more than 5% of total cost of the FDI project.	Payment to the host country including taxes, royalties and other compulsory agreed entrance payments.
	Technology transfers	(0) There is no technology transfer in a form of sharing production specifications and quality control methodology with local suppliers; licensing patented products or processes to local companies; loan or lease of equipment; and knowledge taken away by employees to start their own businesses, (2) There is technology transfer in a form of sharing production specifications and quality control methodology with local suppliers; licensing patented products or processes to local companies; loan or lease of equipment; and knowledge taken away by employees to start their own businesses.	Transfer mechanisms include in-house training for local employees; workshops or mentoring programmes open to suppliers or other local businesses; sharing production specifications and quality control methodology with local suppliers; licensing of patented products or processes to local companies; and loan or lease of equipment.
	Investment in infrastructure	(0) Less than 10% of the investment capital for a foreign investment project is allocated for the construction of basic infrastructure on the project site. (2) At least 10% of the investment capital for a foreign investment project is allocated for the construction of basic infrastructure on the project site.	Part of investment capital of a foreign investment project is allocated for the construction of basic infrastructure on the project site (roads, electric grids, bridges etc.).

<sup>3</sup> While this section only refers to the general sustainable FDI indicators, ESCAP has also developed sector-specific indicators for several sectors by building on the general indicators. Indicators for the following sectors have been developed: mining, chemicals, food, agriculture, ICT, tourism, financial services, power (ESCAP 2021). Indicators for other sectors can also be developed on a needs basis, per country.



**Table 5.4** (continued)

Sustainable Development Dimension	Indicators	Threshold	Definition
<b>Environmental</b>	Resource management	(0) The lack for conservation, protection or recycling technique within an FDI project for the project site. (2) Mechanisms for conservation, protection or recycling technique within an FDI project for the project site,	Presence of a conservation, protection or recycling technique within an FDI project for the project site.
	Pollution controls	(0) The lack of commitments for pollution controls similar to the one existing in its home country as well as industry “best practices.” (2) Presence of commitments for pollution controls similar to the one existing in its home country as well as industry “best practices”.	Commitments for pollution controls similar to the one existing in its home country as well as industry “best practices”.
	CO <sub>2</sub> emissions	(0) The proposed FDI project generate more CO <sub>2</sub> emissions per unit of output compared to the host country level in the IEA database. (2) The proposed FDI project generate less CO <sub>2</sub> emissions per unit of output compared with the host country level in the IEA database for the latest year available.	Comparing the generated CO <sub>2</sub> emissions per unit of output with the host country level in the IEA database.
	Renewable energy	(0) Less than 50% energy use for the project is derived from renewable energy sources. (2) More than 50% energy use for the project is derived from renewable energy sources.	Energy use for the project being derived from renewable energy sources.
	Environmental protection budget	(0) The MNE has allocated less than 1% of the total cost of the project to environmental protection. (2) The MNE has allocated more than 1% of the total cost of the project to environmental protection.	Allocation of a certain budget by the MNEs to environmental protection.
<b>Social</b>	Skills enhancement	(0) Less than 50% of local workers at every career level have been trained annually by the MNE. (1) More than 50% of local workers at every career level have been trained annually by the MNE. (2) More than 50% of local workers at every career level have been trained annually by the MNE, and part of the training include training other than on the site training.	Number of workers trained and the types of training by MNEs under a skills enhancement programme.
	Labour rights	(0) The MNE's proposal does not make commitments to key labour rights including freedom of association, collective bargaining, non-discrimination and workplace safety. (2) The MNE's proposal makes commitments to key labour rights, including freedom of association, collective bargaining, non-discrimination and workplace safety	MNE's commitments to key labour rights, including freedom of association, collective bargaining, non-discrimination and workplace safety.
	Health-care coverage	(0) The foreign company provides health-care coverage for less than 80% of its employees. (2) The foreign company provides health-care coverage to least 80% of its employees.	MNE providing adequate medical support to their workers.
	Wage	(0) MNE pays below the median wage in the host country for the jobs it proposes to create. (2) MNE pays above the median wage in the host country for the jobs it proposes to create.	Wages that the MNEs set to pay host country workers.

**Table 5.4** (continued)

Sustainable Development Dimension	Indicators	Threshold	Definition
	Skill intensity	(0) The number of skilled occupations in the proposed FDI project is less than 25% of the total occupations in that project. (2) The number of skilled occupations in the proposed FDI project is more than 25% of the total occupations in that project.	Skill intensity is defined as the share of skilled occupations (managers, professional and technicians) in total occupations.
	Gender employment equality	(0) The number of female workers proposed in an FDI project is less than the number of male workers. (2) The number of female workers proposed in an FDI project is similar to the number of male workers.	Number of female workers proposed in the FDI project compared with the number of male workers.
<b>Governance</b>	Responsible business conduct	(0) MNE has not adopted a particular set of internationally recognized standards or principles of RBC, such as the OECD Guidelines for MNEs, the United Nations Global Compact and United Nations Guiding Principles on Business and Human Rights. (2) MNE has adopted a particular set of internationally recognized standards or principles of RBC, such as the OECD Guidelines for MNEs, the United Nations Global Compact and United Nations Guiding Principles on Business and Human Rights.	Adoption of International Standards of Responsible Business Conduct.
	Transparency	(0) The MNEs has not committed to an independent audit at least once every two years. (2) The MNEs has committed to an independent audit at least once every two years	External transparency through monitoring, auditing or personnel systems facilitates beneficial access to information regarding corporate policies and operations.
	Local management	(0) Less than one-third of the total management composition being local managers. (2) At least one-third of the total management composition being local managers.	Representation of host country specialists in management.
	Supply chain standards	(0) There is no linkage of a domestic company to a foreign investor's international supply chain. (2) There is at least one linkage of a domestic company to a foreign investor's international supply chain.	Linkage of a domestic company to a foreign investor's international supply chain.
	Stakeholder dialogue	(0) There is no site visit and consultation local stakeholders prior to establishing of the project and once a year thereafter. (2) There is a site visit and consultation with local stakeholders prior to establishing the project and once a year thereafter.	Mechanism for corporate contact and communication with local stakeholders, both to keep them informed and to monitor and respond to local concerns.

Source: ESCAP, 2021.

## 2. Promoting responsible investment conduct, socially responsible investments, impact investments and social businesses

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 emerged in the early 1990s when the practice of including 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 production, 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 both for 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<sup>4</sup> and Guiding Principles on

Business and Human Rights<sup>5</sup> provide useful guidelines for businesses of all types 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 that enables institutional investors to incorporate ESG issues into their decision-making and ownership practices.<sup>6</sup> Another example is the Global Reporting Initiative (GRI) which provides voluntary standards for uniform reporting on sustainability issues and helps to standardise the reporting methodology by companies, including TNCs on ESG issues.<sup>7</sup>

ESCAP's Committee on Trade and Investment Sixth Session, held in Bangkok from 13 to 15 March 2019, discussed a document on "Promoting sustainable investment and business" which provides an overview of international standards, principles and guidelines on responsible business conduct that companies can adopt. It also contains an outline of the various actions that Governments can take to promote and facilitate the uptake of responsible business conduct by companies, including MNEs. Investment, including FDI, can only contribute to sustainable development in as much as the company making the investment is operating and managed in a sustainable way. The need to push sustainability performance through reporting and monitoring of progress is emphasized, and arguments for the development of comprehensive sets of national level indicators to measure the sustainability of investment, including the impact of FDI on sustainable development across the three dimensions, are provided.

With regard to MNEs, the non-binding OECD Guidelines for Multinational Enterprises<sup>8</sup> are probably the most comprehensive set of guidelines for responsible MNE behaviour (see above). In addition, there are various "multi-stakeholder initiative standards" such as the International Standard Organization (ISO) 26000 standard series on social responsibility.<sup>9</sup> Similar standards exist at the sectoral level, such as the Extractive Industries Transparency Initiative.<sup>10</sup> NCTAD, FAO, IFAD and the World Bank jointly developed a set of principles for responsible agricultural investment that respects rights, livelihoods and resources (PRAI).<sup>11</sup>

<sup>4</sup> Available at <https://www.unglobalcompact.org>

<sup>5</sup> Available at [http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR\\_EN.pdf](http://www.ohchr.org/Documents/Publications/GuidingPrinciplesBusinessHR_EN.pdf)

<sup>6</sup> The United Nations Principles for Responsible Investment website at <http://www.unpri.org/signatories>

<sup>7</sup> Available at <https://www.globalreporting.org/standards>

<sup>8</sup> Available at <http://www.oecd.org/corporate/mne>

<sup>9</sup> Available at <http://www.iso.org/iso/home/standards/iso26000.htm>

<sup>10</sup> Available at <https://eiti.org/standard/overview>

<sup>11</sup> Available at <http://unctad.org/en/Pages/DIAE/G-20/PRAI.aspx>

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 also apply to TNCs. In fact, CSR has inescapably become a priority for businesses all around the world. Many organizations produce rankings on companies' performances regarding their social and environmental "good deeds" that often attract significant public attention, whether methodology sound or not (Porter and Kramer, 2006; Farrington and others, 2017). However, while approaches to CSR have generally been criticised for being fragmented, disconnected from businesses and, most importantly, often voluntary, the literature is similarly characterized by contradictory outputs (Porter, Kramer, 2006; Farrington and others, 2017). RBC are therefore a welcome departure; they are not only specific codified standards, but countries adhering to them render implementation binding, while the Guidelines may be subject to national law (OECD, 2011).

UNCTAD (2011c) notes various challenges associated with the above-mentioned standards, including:

- 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;
- 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 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, and that 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 profit's 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). Generally, actors are interested in blended value as well as social impact, and not simply the negation of negative externalities as with "ethical investment", for example (Castellas and others, 2017). The impact investment process sees impact-seeking purchasers, including Governments and foundations, target impact-driven organizations, those that have long-term social missions and specific targets via certain forms of finance, such as charity or social impact bonds, or channel organizations, including social banks or community development finance institutions (Social Impact Investment Taskforce, 2014). Out of the global impact investment total of US\$502 billion in 2018, around 15% targeted Asia. Financial services often feature among the top sectors for impact investment. In South-East Asia, 75% of capital was derived from financial services, while 85% of that targeted microfinance institutions. Countries in the Asia-Pacific region find themselves at very different developmental stages and have very different business climates, and thus their impact investment ecosystems vary widely. Cambodia, due to its open economy, has been able to attract approximately as much impact investment as the Philippines, Viet Nam and Indonesia combined during 2007-2017 (ESCAP, 2020).

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 such as, for example, a non-profit organization that fully owns and controls a business entity (ESCAP, 2013). When an MNE 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.



### The impact and social investment environment in Australia

In line with the impact of investment focus on blended value and social entrepreneurship, the Government of Australia's departments at the federal and state levels have jump-started a variety of cultural, social and environmental endeavours. The largest, and arguably most impactful, of which has been the Social Enterprise Development and Investment Fund (SEDIF). Launched in 2010, its funds were overseen by the Department of Education, Skills and Employment until 2016, when three funds were selected to manage the SEDIF resources – Foresters Community Finance, Social Enterprise Finance Australia (SEFA) and Social Ventures Australia. This way, AUS\$20 million were made available to develop impact investment and social enterprises from the public side, which were then matched by private investments from social banks, institutional investors, charitable trusts and foundations. SEDIF aims to improve support and finance for eligible enterprises so that business operations and positive impact can be widened for communities.

A 2016 governmental evaluation found that SEDIF had largely met expectations. It had successfully mobilized 124% of its initial public pledge and had made a considerable contribution to impact investment market in the country, which was congruent with one of the main government objectives. Furthermore, SEDIF contributed considerably to capacity-building and the scaling of social impacts directly for 64 of its supported enterprises, while moderately contributing indirectly to capacity development for 424 projects. Available data also indicated that positive outcomes had been achieved for 9,051 people, while some 650 had entered employment or were employment ready.

Since 2016, fund management has been decentralised to tailor support more precisely to business needs. Overall, SEFA, for example, provided capital and resources for around 80 social enterprises and 100 social entrepreneurs. More than AUS\$40 million have been disbursed in more than 50 deals. SEFA was able to improve its financial performance in 2020 by AUS\$97,078 vis-à-vis 2019, while expanding its support for purpose-driven organizations: two new clients were taken on, while six repaid their loans entirely. On the project level, The Sydney Retreat is a good example of its operations. The community enterprise serves as a reasonably priced shelter for addicts and alcoholics. It offers 40 beds for 30-day educational programmes at rates approximately 75% below private clinics. This will benefit up to 240 clients a year.

SEFA provides blended deals for business with limited repayment resources where it partners with philanthropists and the Government such as, for example, direct investments for organizations with excellent track records and good prospects for repayment, co-investments enabling business to scale-up and cooperating with impact investors to disperse higher volume loans.

Australia has, therefore, created a decentralised, dense ecosystem of impact investment finance provision, support and assessment for a variety of causes. For a summary and discussion of the shortcomings, please refer to the evaluation report of the Department of Education, Skills and Employment (2016).

*Sources:* SEDIF, 2016; Castellas and others, 2017; Department of Education, Skills and Employment, 2016 and 2021; and SEFA, 2020 and 2021.

As of today, social MNEs are rare and most social enterprises are SMEs. However, Governments can play a role in promoting the adoption of responsible business practices or conduct and corporate social responsibility in all enterprises, including foreign ones. 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 an RBC 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 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 in to support socially responsible investment and the adoption of RBC include (but are not limited to) the following (ESCAP, 2009b and 2020):

- **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: (a) defining minimum standards for business performance embedded within the legal framework; (b) establishing targets for business to achieve; (c) setting up enforcers and inspectorates to oversee business conduct; (d) promulgating codes or laws to confine undesirable business conduct; (e) mandating corporate contributions to community; or (f) imposing licence for 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 5.7).
  - **Facilitation.** 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, a Government plays a catalytic, secondary or supporting role. For example, a Government may: (a) provide tax incentives and penalties to promote responsible business; (b) ensure business can access information needed; (c) facilitate understanding of minimum legal requirements for issues related to responsible business practice; (d) include CSR elements in related policy areas (such as industrial policy, trade policy, environmental policy, and labour policy); (e) offer capacity-building, business advisory services and technical assistance to businesses when needed; or (f) 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 an 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 (a) initiating dialogue in multi-stakeholder processes; (b) supporting joint government-industry collaboration in capacity-building and developing sectoral RBC/CSR guidelines; (c) engaging stakeholders in standards-setting processes; (d) promoting public-private partnerships for community development; and (e) mobilizing resources. In this role as broker, government can also stimulate the engagement of key actors in an RBC/CSR agenda by, for example, providing funding for research or leading campaigns, information collaboration and dissemination, training or raising awareness.
  - **Warranting.** Last, Governments can provide political support and public warrant of an 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 (a) commitment to implement international principles; (b) education or awareness-raising programmes; (c) official policy documents; (d) publicity of good RBC practice conducted by other leading companies; (e) specific RBC-related award schemes (such as a National Green Business Award); or (f) 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.
- 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 (ESCAP, 2009b; UNCTAD 2011c):
- 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;



### 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 1 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 that 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 US\$80 million);
- A turnover of at least Rs. 10 billion (approximately US\$160 million);
- Net profits of at least Rs. 50 million (approximately US\$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 did not. 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. In January 2021 the Ministry of Corporate Affairs announced two amendments to the “New Act” – the 2019 and 2020 Companies (Amendment) Acts. These have moved the regime from “comply or explain” to strictly mandatory obligations including monetary penalties for breaches and non-compliance.

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 of 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 are of violation of the Act. Second, if an Indian company undertaking CSR is a subsidiary of a United States entity, or if its business activities “touch” the United Kingdom, then the United States Foreign Corrupt Practices Act (“FCPA”) or the United Kingdom 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 the full article see <http://www.jonesday.com/Indias-New-Corporate-Social-Responsibility-Requirements—Beware-of-the-Pitfalls-04-15-2014>); Chadda, 2021; Vasani and Kannan, 2021.*

\* Note: exchange rate as of April 2014.

- Reforming regulatory frameworks to meet international standards;
- Fostering interaction, consultation and dialogue with stakeholders, e.g., business, NGOs and other key stakeholders;
- Encouragement and support for the development of RBC/CSR standards, including through the provision of material support, technical expertise and mobilizing the participation of relevant stakeholders;
- Support for 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;

- Application of RBC/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;
- Partnering with donor States to deliver capacity-building initiatives and technical assistance to local industry and regulatory bodies;
- Promotion of RBC/CSR disclosure and responsible investment, including by stock exchanges;<sup>12</sup>
- Adoption of some of the older CSR standards as part of regulatory initiatives, turning hitherto voluntary standards (soft law) into mandatory requirements (hard law);
- Strengthening the compliance promotion mechanisms of existing intergovernmental organization standards;
- Promotion of socially and environmentally sustainable inward and outward investment, while avoiding discriminatory practices that would be a form of protectionism, through an appropriate incentive scheme;
- Strengthen RBC/CSR principles in IIAs.

### 3. Country examples – sustainability in investment strategies

Below are a number of case studies on how countries in the South-East Asia region have dealt with sustainability in their investment strategies and policies

#### Indonesia

Indonesia was a front runner within ASEAN with regard to integrating CSR into its legislative framework<sup>13</sup> in the early 2000s. The Government also began to place emphasis on RBC around the same time, through the issuance of the National Committee for Governance Policy (KNKG)<sup>14</sup> and the establishment of the National Committee for Corporate Governance Policy (KNKCG).

More recently, in 2017 the National Commission on Human Rights and the Institute for Policy Research and Advocacy submitted several recommendations for promoting business and human rights; since then, it has been taken up by the Law and Human Rights Ministry which is now developing a National Action Plan on Business and Human Rights (NAP) in the plantations, mining and tourism sectors.<sup>15</sup> It is critical that the NAP covers a broad range of RBC areas and that it is designed to effectively support coherency among various government agencies on the matter.

Indonesia has proactively worked towards sustainable development and has undergone two Voluntary National Reviews (2017 and 2019) to evaluate its progress in achieving the SDGs. These reviews have highlighted the RBC-activities in Indonesia that have been undertaken by the private sector and civil society, in particular through Indonesia Business Links (IBL), which has been working since 1999 to promote and implement numerous RBC-initiatives in the country. “IBL has also promoted the green economy concepts, targeting adoption by Bappenas, as well as creating a philanthropy platform for the SDGs.”<sup>16</sup>

#### Malaysia

To remain in line with its international commitments, Malaysia has integrated the SDGs into its investment strategy, and is promoting investment opportunities in a wide range of SDG priority sectors through the Malaysian Investment Development Authority (MIDA). In particular, it welcomes foreign participation in advanced electronics and automated manufacturing, R&D, biotechnology, photonics, logistics and innovation.

Among these sectors, green technology has been identified as one of the top priorities of the Government. In line with this, in 2009 the country launched its National Green Technology Policy,<sup>17</sup> which focuses on four main sectors – energy, building, waste management and transportation. In 2019, 350 projects in renewable energy and 75 projects in energy efficiency/energy conservation were implemented under this initiative.<sup>18</sup> In order to

<sup>12</sup> For example, the Malaysian stock exchange has made CSR reporting mandatory for all listed companies, and China’s Shanghai Stock Exchange published the Shanghai Environmental Disclosure Guidelines, with which listed companies are urged to comply (UNCTAD, 2011c).

<sup>13</sup> Notably through the Company Law 40/2007 and the Law on Mineral and Coal Mining 4/2009.

<sup>14</sup> Decree of the Coordinating Minister for Economy Number: KEP/31/M.EKUIN/08/1999.

<sup>15</sup> OECD (2020c) OECD Investment Policy Reviews: Indonesia 2020. Available at: [https://www.oecd-ilibrary.org/sites/b56512da-en/1/3/3/index.html?itemId=/content/publication/b56512da-en&csp\\_=3566eda5c71b885d65a0049c7e7c9b6d&itemIGO=oecd&itemContent Type=book](https://www.oecd-ilibrary.org/sites/b56512da-en/1/3/3/index.html?itemId=/content/publication/b56512da-en&csp_=3566eda5c71b885d65a0049c7e7c9b6d&itemIGO=oecd&itemContent Type=book).

<sup>16</sup> *ibid.*

<sup>17</sup> The Asia Pacific Energy Portal. Available at [https://asiapacificenergy.org/#main/lang/en/time/\[1990,2020\]/geo/\[\]/search](https://asiapacificenergy.org/#main/lang/en/time/[1990,2020]/geo/[]/search)

<sup>18</sup> Official website of the Malaysian Investment Development Authority (MIDA), Green Technology, Available at <https://www.mida.gov.my/home/clean-technology-&-environment-management/posts/> (accessed 25 November 2020).



attract further foreign investors and strengthen the development of green technology, a Green Investment Tax Allowance (ITA) and an Income Tax Exemption (ITE) were introduced in 2014.<sup>19</sup>

In 2014, the SRI Sukuk Framework<sup>20</sup> was introduced to facilitate the creation and the financing of an ecosystem that promotes sustainable and responsible investing for sustainable and responsible investors and issuers. The goal is to spotlight the initiatives that benefit the environment and society. To maintain this momentum, the Securities Commission Malaysia (SC) released the Sustainable and Responsible Investment Roadmap for the Malaysian Capital Market (SRI Roadmap) in 2019.<sup>21</sup> Through this initiative, Malaysia is seeking to become a regional leader in sustainable investment. To achieve this, the SC has facilitated the SRI ecosystem, widened the range of SRI instruments, increased SRI investor base and strengthened the internal governance culture. Also, under the SRI Roadmap, the SRI Sukuk Framework has been revised to expand the list of eligible SRI projects. This initiative highlights the need to further involve the private sector in meeting the green, social and sustainable gap in the country.

### Viet Nam

In 2017, Viet Nam launched the National Action Plan to implement the 2030 Agenda for SDGs (SDG NAP), in which 17 SDGs have been nationalized into 115 Viet Nam SDG (VSDG) targets that take into consideration the national development context and development priorities. These VSDGs have been further mainstreamed into the draft of FDI strategy for 2018-2023 proposed by the Ministry of Planning and Investment with the World Bank's assistance, and the Resolution 50-NQ/TW.

Resolution 50-NQ/TW contains three objectives, all of which are aligned with the SDGs, i.e., fostering a higher contribution of foreign enterprises with high-valued, advanced, efficient and environmental responsible technologies in the economy, increasing the FDI localization rate and enhancing the proportion of skilled and trained labour within the national employment structure. Furthermore, another core aim of the Resolution is to enhance the linkages between multinationals and local SMEs.

Following the FDI strategy's draft, environmental-friendly technologies (e.g., water conservation, solar and wind energy), manufacturing of pharmaceuticals and medical equipment, and education and health services have become priorities for FDI attraction and promotion in both the short term and long term.

<sup>19</sup> Ibid.

<sup>20</sup> Securities Commission Malaysia, 2014.

<sup>21</sup> Securities Commission Malaysia, 2020.

## C. The national legal framework for FDI

The legal framework for FDI provides the overall institutional and policy framework that regulates foreign investment. Policies and institutions are drafted and issued basis adopted laws and regulations. Therefore, policies and institutions cannot be viewed in isolation from the legal framework. Investment policies need to be formulated before investment legislation can be drafted. Investment legislation "translates" the policy into legal terms that are actionable including in a court of law (Kobina and Forneris, 2010). It is therefore important that the policy is clear to ensure an effective law-making process. The legal framework provides 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 & 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.

The legal framework for FDI does not operate in vacuum. Domestic investment laws form an important part of this framework because they provide clear rules on the mode, manner, and extent of FDI permitted in a country. Laws dictating FDI may include a gamut of considerations stemming from environmental, labour, and antitrust law, along with the practices found in investment agreements. Law principally is based on the principles of rule of law, requiring it to be fair, consent-based, transparent, accessible, and predictable. The presence of these factors is important and often distinguishes FDI-welcoming countries from indifferent ones. Practically important factors such as the presence of special economic zones, foreign ownership of land and the ability to obtain intellectual property rights are important because they help investors assess the extent of autonomy granted to them by the legal

regime and these factors are generally a positive indicator because they demonstrate the jurisdiction's willingness towards foreign ownership of tangible and intangible assets generally. These factors will be addressed in greater detail in the upcoming sections.

## 1. Domestic investment laws

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 especially when companies are making their investment decisions. Companies are often seen assessing regulations, policies and legal framework. (Shin and Kim, 2011). 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 (Ratner, 2021; also see below). It is important to emphasize that these international provisions are a part and parcel of domestic law and in case inconsistencies prevail over domestic law (See e.g. Sauvant et al, 2014; Bath and Nottage, 2021; Portales Undurraga and Rodríguez Chiffelle, 2021). 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.

Apart from these additional areas of law that affect FDI also exist. Sometimes these areas are covered by a general foreign investment law, though an elaboration in separate laws is usually present. 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 (Wang, 2010). In fact, 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 which raised the fundamental question of the role of the rule of law.

## 2. The rule of Law and FDI

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 (Stoll, 2018; Echandi, 2021). A few guiding principles are presented here for formulating 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 5.8). 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 be altered or modified often hence promoting certainty. Fourth, it should be formed with the 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** (Qian, 2018; Deva, 2021). Seventh, it should **ensure** public safety and order. Eighth, it



### The Investment Law of Uzbekistan (2020)

Uzbekistan's Law No. ZRU – 598 “On Investments and Investment Activities” was adopted and entered into force in January 2020. It provides an overview of all the important commandments required to be followed across the process of investments and investment activities for domestic and foreign investors, with the exception of centralized activities. Broadly, these commandments are based on the ideas of legality, openness, freedom of implementation, justice and equality to subjects, non-discrimination, and investor conscientiousness. It provides overriding powers to any treaty entered into by Uzbekistan with respect to investment activities. With respect to the scope of the legislation, it permits investments relating to the social, entrepreneurial, and scientific sphere. The permitted modes of investment include incorporation of new legal entities or holding companies, concessions, acquisition of ownership rights such as intellectual property or land plots among others.

The Law allows foreign investors to undertake free disposal and transfer of funds, obtain repayment if their investment or investment activity has been terminated by the State, and obtain protection from expropriation and nationalization along with complete transparency with respect to disclosures. The Law also imposes obligations on investors such as payment of taxes, fulfilment of all contractual obligations, payment of indemnity in case of non-following of contractual or statutory obligations, and compliance with domestic and regional laws applicable on them. In return, the Law recognizes institutionalized State support for investment and investment activities such as provision of incentives and preferences, centralized investments from the government for the project's co-investment, as well as support by the means of financing, consulting, or the provision of information. Another striking feature of this Law is the creation of additional instruments such as investment tax credit and investment subsidies for supporting investors.

The Law also establishes the procedure of entering into an investment agreement, subject to mandatory conditions being specified in the said agreement. According to this, the agreements must specify timelines for completion of projects, anti-corruption and anti-monopoly clauses, rights and obligations of the parties with regard to compliance with the rules, regulations, and standards established by domestic law and specifically delineate the liability of parties in the event of non-compliance. In lines with this, granting investors exceptional conditions and exclusive rights that might allow market dominance is expressly prohibited. Furthermore, unilateral termination (coupled with an elaborate procedure giving the investor a chance to state his case) has also been provided for in the Law.

The Ministry of Investment and Foreign Trade of the Republic of Uzbekistan (referred to as MIFT in the legislation) has been named the authorized State body in the field of investment activities, with duties to implement general State policy in the sphere of investment and the coordination of activities of other state bodies working in related fields. MIFT is required to consult with potential investors on legal, economic and other matters of activity and support them with all necessary aid and assistance in addressing emerging issues.

While the law has ensured that the legal regime governing foreign investments broadly stays the same, it has specified new incentives and property rights for investors which appeared to have been absent previously. The creation of investor tax credit and investment subsidies have also been hailed as a landmark development towards investor protection and encouragement. Lastly, the change in the institutional mechanism with the MIFT in-charge of all things related to FDI is an important simplification of processes and ensures that investors can have coordinated guidance for all queries. The dispute resolution clause has also been revamped. It is a multi-tier clause first requiring good faith negotiations, after which the next tier is mediation. Finally, the third way to resolve the dispute is to submit it to the national courts of Uzbekistan.

The law can be accessed at <https://investmentpolicy.unctad.org/investment-laws/laws/328/uzbekistan-the-law-on-investments-and-investment-activity>.

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. 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 (Sauvant, 2021). 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, to ensure sustainability as well, particularly when it comes to maintaining sustainable FDI. This aspect has assumed increased importance in recent years in both national and international legal frameworks.<sup>22</sup> 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. 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 inseparable as no institutional framework can be developed without the foundations of a clear legal framework.

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 is 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 it 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.

Foreign investment 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 versus 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 IPI (Kobina and Forneris, 2010). Broadly, the IPA performs regulatory functions, or assist with promoting the country as a destination for FDI to a business audience consisting potentially of investors. Moreover, the World Bank Group has published a detailed evaluation prepared by the Independent Evaluation Group which assesses the comprehensive string of investment climate and regulatory reforms supported by the World Bank Group in client countries (World Bank Independent Evaluation Group, 2015). It identified key concerns, such as political instability, that bother investment climates generally and made recommendations accordingly.

The adoption of a domestic 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 to the same. Such laws are important in policy implementation with respect to the role of the private sector and FDI in the economic development of a country. They generally do so by clarifying the rights and obligations of both the foreign investor and government and its institutions, to provide more certainty to the regime. Furthermore, these laws are useful for investment promotion because they can help investors gauge the investment climate and scenario in the country to take a calculated decision. Another major benefit is that these laws can also provide security to private

<sup>22</sup> See OECD, 'Enhancing the Legal Framework for Sustainable Investment: Lessons from Jordan'; Won L. Kidane, 'The Legal Framework for the Protection of Foreign Direct Investment in Ethiopia' in Fantu Cheru, Christopher Cramer, and Arkebe Oqubay (eds), *The Oxford Handbook of the Ethiopian Economy* (OUP 2019).

investments and specifically provide investment protection and dispute settlement mechanisms, which are important to increase transparency and overall good governance at the policy level.

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 5.8 above detailing the law of Uzbekistan) 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). 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 has developed its investment laws navigator<sup>23</sup> which provides an update of the extent and coverage of investment laws around the world. The Investment Laws Navigator is a comprehensive and regularly updated collection of national investment laws. It currently contains 185 investment laws. It contains the full text of the laws and offers user-friendly tools for searching and filtering for selected provisions that are specifically relevant to foreign investors.

The Navigator is designed to provide accurate and authoritative information and all laws are identified through a systematic review of government and business intelligence sources and verified to the fullest extent possible. Through its monitoring and analysis of investment laws, UNCTAD is uniquely placed to contribute to the international investment policy discourse and to provide advisory services and technical assistance to countries interested in reviewing or reforming their regulatory framework for foreign investment. The database of national investment laws is maintained by UNCTAD's Investment Policy Research Section.

In its publication of the Investment Policy Monitor (2021), the UNCTAD indicated that investment laws are at the core of foreign policy, tracing developments involving increasing restrictions to address national security concerns faced by multiple countries. Among the main findings of this publication, the report first highlighted the increasing reach of foreign investment laws, with 185 countries utilising these provisions to govern investments. It noted that there

have been an array of developments pertaining to investment policy, from the signing of multiple IIAs to discussions at the UNCITRAL Working Group III on the reform of ISDS. Specifically tracing the recent rise in protectionist measures, it noted the impact of investment laws on policy and the important of these laws as a reflection of diplomatic stances. However, it noted that the overarching essence of investments – facilitation – was being embraced and promoted by countries through fiscal incentive regimes and other measures.

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 a few principles that provide general guarantees to foreign investors. While the manner, extent and scope of such guarantees is ever-changing and subject to the discretion of the sovereign States involved, the foundation upon which these guarantees are built is somewhat uniform. Generally, treaties try to ensure equal treatment of foreign and domestic investors through the 'most-favoured nation' or 'national treatment' clause. Other than this, there is often a guarantee to protect investors from arbitrator nationalisation, unlawful expropriation or confiscation of property, or other governmental measures having a similar effect coupled with fair compensation in the event of loss through such measures. Additionally, foreign investors are often permitted to convert and/or repatriate their capital and earnings. Occasionally, some host States allow foreign investors to expatriate their own labour, foreign experts, managers and technical personnel and access to international dispute resolution wherein a foreign investor can file a claim against host States directly.<sup>24</sup> Lastly, there is the all-important fair and equitable treatment clause to guarantee that there is no coercion, unjust enrichment, bad faith, absence of transparency, or denial of legitimate expectations of investors.

In line with the trend to rebalancing international investment agreements (see section D 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.<sup>25</sup> The World Bank advises that investment promotion and incentives are covered in

<sup>23</sup> UNCTAD, 'Investment Laws' <https://investmentpolicy.unctad.org/investment-laws>

<sup>24</sup> World Bank, 'Investment Policy and Promotion' *World Bank Brief*, 8 June 2021

<sup>25</sup> Henry Loewendahl, 'Innovations in Foreign Direct Investment Attraction' IDB, November 2018

separate pieces of legislation. In particular, incentives should be defined and organized in tax/customs codes/laws rather than investment codes/laws (see chapter 6).

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.

### 3. Special economic zones and FDI

Special Economic Zones (SEZs) are separate geographical area where business and trade regulations differ from the ones that are applicable in rest of the country. These regions are within the domestic borders, with an objective to facilitate trade, business, investment, and taxation. Despite their significant importance under international law, there is yet no precise “official” definition of SEZs (Chaisse, 2020). The primary objective up setting up the initial SEZs, in form of Export Processing Zones (EPZs) was to encourage Foreign Direct Investment (FDI). These were done in manufacturing sectors which were primarily labor intensive to increase export, attract FDI and foreign exchange. SEZ have often played critical role in development and overall growth of their economy. Developing countries especially have found it very difficult to attract FDI. Special Economic Zones (SEZ) have created an opportunity for such economies to expand, diversify, and modernize their industries with the help of increased FDI. These countries are strengthening firm-level cooperation, connectivity, and innovation in order to raise firm-level investment and boost firm-level productivity through FDI (Zeng 2021).

International economic law has played a crucial role in promoting export, trade and FDI among states. However, with changing times, states have found a new way to reclaim their sovereignty. SEZ are often considered as a form of unilateral economics law. Rather than applying international trade and investment law the states follow domestic laws within the SEZ to encourage trade and FDI. There are major distinctions between the international trade and investment law versus the laws that are applicable in SEZ. An international treaty is formed with the consensus of all the participating States however the SEZs are in complete control of the state. This implies that it the laws and regulations can be modified as per the states will without necessarily cooperating with other states. The next important difference is the matter of special jurisdiction. Since

SEZ are established by the states the states have full authority to form new policies for these zones. However, under international law, states are required apply the international treaty to the whole domestic territory. SEZs have become a source for the states to apply national laws to attract trade and foreign investment. (Chaisse & Dimitropoulos 2021)

It is a well-known fact that SEZ are formulated by states and are under control of the respective states. The investors in SEZs are qualified to bring treaty violations claims and ISDS tribunals have jurisdiction on majority of SEZ-related dispute. In ISDS framework any person or entity, either private or a public undertaking being an investor has the right to take the host State to arbitration, which earlier was only limited to States. However, history has shown that the host states have lost most of the times in ISDS claims where SEZ were involved. The tribunals are also reluctant to take into consideration the need of SEZs as a form of unilateral economic law. Hence it becomes important for the states to formulate SEZs in light of the provisions of IIAs. (Chaisse 2021) ISDS as a dispute settlement framework has been a way forward from the customary international law.

SEZs are discussed in detail in chapter 6 of this Handbook.

### 4. 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 behavior and exploit the land, including land speculation that would drive up prices, with little benefit for the host country or the local economy; 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 fueled 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. 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. 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 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.

However, 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) distinguish 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) conclude 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 11 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.<sup>26</sup>

Investment in agriculture can support sustainable development and help meet growing food security needs. Yet, if not structured equitably or regulated carefully, investments can fail to provide benefits to host governments while dispossessing people of their land, livelihoods and rights. These risks have only heightened as investments in land for agriculture remain attractive to foreign investors and host countries alike. The Columbia Center on Sustainable Investment (CCSI) focuses in particular on investment in land and agriculture and also provides training. CCSI's work in this area focuses on how to maximize the benefits of agricultural investments while minimizing potential harms and avoiding rights abuses.<sup>27</sup>

## 5. The role of IPR protection in FDI attraction and technology transfer

As countries develop, the adoption of laws in particular areas previously not considered essentially becomes more important to ensure the sustainability of the development process. A clear example is laws governing intellectual property rights (Papageorgiadis, McDonald, Wang & Konara, 2020; Vanhonnaeker, 2021). 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.

Since the adoption of the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS), attention to IPR and their protection have significantly increased, in particular with regard to their role in attracting FDI (Papageorgiadis, Christopolou, Wang & Magkonis, 2021; Marisi and Chaisse, 2019). 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 omitting 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 MNEs from developed countries. These MNEs would normally not target LDCs or other developing countries which focus on the attracting of resource or market-seeking or labor-intensive efficiency-seeking FDI which does not involve high technology. As a result, MNEs active in these sectors would normally not look at the level of IPR protection as an important determinant.

However, when a 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 (Vanhonnaeker, 2021). Various studies have shown a positive link between the level of IPR protection and FDI (Ghosh & Yamarik, 2019). IPR would obviously be

<sup>26</sup> Committee on World Food Security, 'Voluntary Guidelines on the Responsible Governance of Tenure of Land, Fisheries and Forests in the Context of National Food Security'.

<sup>27</sup> Columbia Center on Sustainable Investment, 'Sustainable Investment in Land, Agriculture & Food Systems'.



expected to play an important role in countries specifically targeting FDI in R&D. The attraction of FDI in R&D depends on various factors, not just IPR but the availability in the host country of world class research infrastructure and skilled labor 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, paperwork and time associated with creating an R&D enterprise, apart from IPR protection.

In developing 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. Studies shows 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, 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 are also important along with other determinants of FDI.

## 6. Digital Economy and FDI

It is safe to say that the world economy is transforming digitally with full speed. The digital economy refers to the global network of economic activity, commercial transactions, and professional relationships facilitated by information and communication technology. As the digital economy is evolving it is challenging long-held beliefs about the organization of businesses, the interaction between corporations and manner which consumers receives services, information, and commodities. The basis of digital economy is the greater connectivity between organizations and consumers because of fast growing internet technology. The internet has made it very convenient to share data within and across multiple countries.<sup>28</sup>

It is well settled that FDI bring capital into a host state.<sup>29</sup> In addition to monetary benefits it also brings with it an advantage of new technology and increased knowledge. To transform the global economy into a digital one, it is imperative to attract of FDI into various economies. There are mainly three categories of policies, regulations, and measures

through which states can attract digital FDI. Firstly, those policies that facilitate investment in new digital activities. Secondly, the ones that facilitate existing businesses to invest in the adoption of digital services. Lastly, those that allow investment in digital infrastructure. While investing in new digital activities, investors take into consideration investor-friendly data security regulations, data privacy regulations and copyright laws to protect intellectual property. Further availability of e-payment services and support for starting digital businesses and for local digital skills development are the main requirements that the investors look for while investing in the adoption of digital services. Also, while investing in digital infrastructure, investors consider multiple factors such as investor friendly process of receiving licenses for digital infrastructure, the availability of skilled workforce, the regional coordination

While economic growth and knowledge transfer to the host nation are essential outcomes of FDI, technical infrastructure development and human capital development are inherent benefits of FDI (e.g. IT boom in India and Philippines). Digital FDI can be defined as the effort to attract foreign direct investment into a digital economy. In order to do so, certain policies and measures are required which are mentioned in the above section.

For investment policymakers, the digital transition brings both constraints and possibilities. The digital transition can be accelerated by international investment. In response, investment strategies must change and respond to new problems brought by new business models based on new technology. Prospective treaties can provide both potentials for commitments and the appropriate policy space for governments to regulate on issues such as data protection, cybersecurity, localization requirements, online consumer protections, e-government services, and prohibitions on forced technology or source code transfers. Domestic laws can be addressed through investment agreements.

## 7. The World Bank's rule of law indicator

Next to the importance of strong IPR protection, the Rule of Law indicators provided by the World Bank Group estimates the extent of the perception to which agents have confidence in and abide by the rules of society for 206 countries. Particularly, the quality of contract enforcement, IPR, the police, and the courts, as well as the likelihood of crime and violence are included in the indicator (World Bank

<sup>28</sup> UNCTAD, 'Digital Economy Report 2021' UNCTAD, 2021

<sup>29</sup> Jan Knoerich, 'How does outward foreign direct investment contribute to economic development in less advanced home countries?' (2017) 45:4 Oxford Development Studies, 443-459.

Group, 2021). Countries having a superior legal framework regulating FDI have a few common characteristics. Generally, they allow FDI across and in all sectors and ensure that there is equal treatment of foreign and domestic investors. This is coupled with a simple and transparent establishment process that provides easy and secure access to and use of land through ownership or long-term leases that maintain an efficient land acquisition procedure. They also enforce strong arbitration laws and allow access to domestic and international arbitration, with recognition and enforcement of foreign arbitration

awards. They also conform to international principles and laws along with a supportive, independent, efficient, and impartial court system and fair trials along with superior legal services. Lastly, they offer adequate IPR protection and enforce non-restrictive labor laws and permit 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 5.9).



### Box 5.9

#### 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.

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

As countries develop, obviously the legal frameworks 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. Such developments portray 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).

#### D. The international legal framework for FDI

The national legal framework has been increasingly modified by commitments made by governments at the international level (Bath and Nottage, 2021). 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)).

This section first briefly provides an overview of the manner in which investment rulemaking occurs, with reference to types of IIAs such as BITs, TIPs, investment contracts, etc. Next, it discusses the structure of IIAs, throwing light on key provisions in these agreements and their general structure. This is followed by a detailed discussion on the substantive protections available to investors and the dispute resolution clauses in these agreements. Lastly, in light of recent discussions surrounding the purported legitimacy crisis in ISDS, it discusses the UNCTAD's Plan for Reform of IIAs and the roadmap for the future of international investment law generally.

## 1. International investment rulemaking and investor-State dispute settlement: An Overview

IIAs comprise of 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).<sup>30</sup> Avoidance of double taxation treaties (DTTs) are also FDI-related but are 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 MNE system (Chaisse, 2016; Mosquera, 2021). As IIAs (and DTTs) are agreements between two or more governments they are governed by international law (the Law of Treaties for instance). UNCTAD's International Investment Agreements 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 have been made some time ago to conclude a multilateral agreement on investment (MAI) (Rugman, 1998). However, these efforts came to nothing as developing countries feared that the agenda was too much driven by developed 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 5.10).

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 MNEs are the owners of intellectual property and intellectual property is normally recognized as a form of investment as defined in international trade agreements and investment treaties (Chaisse and Marisi, 2018). Attempts to include trade and investment as a formal negotiation area (part of the so-called “Singapore issues”<sup>31</sup>) failed due to similar concerns surrounding the MAI (Box 5.10).

In addition to these WTO agreements, 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. The G20 Guiding Principles for Global Investment Policymaking discussed in chapter 4 could also be interpreted as a prelude towards deeper and wider global investment rules.

Given the challenges related to the MAI more recently the United Nations Commission on International

<sup>30</sup> For a detailed definition and coverage of TIPs, see UNCTAD (2016c), Box III.3.

<sup>31</sup> The “Singapore issues” 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. See WTO, ‘Understanding the WTO: Cross-Cutting and New Issues: Investment, competition, procurement, simpler procedures’ [https://www.wto.org/english/thewto\\_e/whatis\\_e/tif\\_e/bey3\\_e.htm](https://www.wto.org/english/thewto_e/whatis_e/tif_e/bey3_e.htm)



### 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.<sup>32</sup>

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.<sup>33</sup>

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 a possible 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.<sup>34</sup>

Nonetheless, the WTO states there is a steady progress in the negotiations for an investment facilitation agreement for which this initiative currently has the participation of over 110 members, up from the 70 that supported the Joint Ministerial Statement on Investment Facilitation for Development launched at the 11th Ministerial Conference held in December 2017 in Buenos Aires. The participants in the negotiations aim to have an agreement finalized by the end of 2022 (World Trade Organization, 2021).

*Source:* OECD, references quoted in text. See also UNCTAD (2021)

<sup>32</sup> OECD, ‘Multilateral Agreement on Investment’

<http://www.oecd.org/investment/internationalinvestmentagreements/multilateralagreementoninvestment.htm>

<sup>33</sup> Global Policy Forum, ‘Multilateral Agreement on Investment’ <https://www.globalpolicy.org/globalization/globalization-of-the-economy-2-1/multilateral-agreement-on-investment-2-5.html>.

<sup>34</sup> 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 in 2003. Only trade facilitation was kept as a negotiation issue which ultimately resulted in the adoption of the WTO Agreement on Trade Facilitation which entered into force in 2017.

Trade Law (UNCITRAL) has put the idea of an Advisory Centre on International Investment Law (ACIIL) on its agenda. The Centre is meant to help under-resourced developing countries in international investment disputes (Sauvant, 2019). Efforts to establish an Advisory Centre on International Investment Law (ACIIL) can learn from the successful approach pursued in another field, namely the international trade area, when interested governments created the independent Advisory Centre on WTO Law (ACWL) as an intergovernmental organization. The ACWL was established in 2001. As of September 2021, 82 countries were entitled to its services: of which 39 were developing and 43 were least developed countries.

The ACWL provides a range of important services to its beneficiaries: all developing countries that have become members of the Centre and have contributed to its Endowment Fund (Sauvant, 2019). In addition, LDCs are automatically entitled to the Centre's services, without having to become ACWL members or having to contribute to its Endowment Fund, if they are WTO members or are in the process of becoming members (Developed countries are not entitled to the Centre's services). The services that the ACWL provides are:

1. giving free advice, in the form of legal opinions, to governments on all procedural and substantive issues arising under WTO law;
2. assisting countries (for modest fees, but free-of-charge for LDCs) in all stages of the WTO's regular panel and Appellate Body proceedings as complainants, respondents and third parties, beginning with the initial assessment and preparation of cases and including advocacy at panel meetings (including answering questions from panels and parties at the meetings), to drafting notices of appeal and advocacy during Appellate Body hearings;
3. supporting alternative dispute settlement proceedings; and
4. holding trainings on WTO law and procedures, as well as arranging secondments for government lawyers at the Centre. 31 In 2018 alone, the ACWL prepared 237 legal opinions, assisted developing countries in 17 disputes (including five new ones), awarded training certificates to 39 delegates, and undertook various ad hoc trainings.

In accordance with the provided services of the ACWL, the emphasis lies in providing all States with actual access to the regime's dispute-settlement mechanisms, such that they can defend themselves in the best possible manner. The importance of this is

explained in twofold. First, the rise of international investment disputes and their accompanied costs. Second, many developing countries do not have the experienced personnel and financial resources to defend themselves in such international disputes. The proposal for an Advisory Centre on International Investment Law that is now on the agenda of UNCITRAL's Working Group III is therefore meant to rectify these deficiencies.

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 (Ho, 2018). 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/royalty arrangements, etc., from mining projects. These contracts typically call for international dispute settlement mechanisms between governments and a foreign investor, like ISDS provisions in intergovernmental IIAs. As a result, they can bypass local courts. The efficiency of such contracts, however, also depend on their coherence with national investment policies and with other bodies of international law. While this does not necessarily imply legal homogeneity within legal investment frameworks, different policy areas and legal instruments should work in synergy. Divergence between the national and international dimensions of a country's investment policy regime may be intentionally, therefore both dimensions need to be shaped in a way that interaction maximizes synergies, including from a sustainable development perspective.

The strengthening of cooperation between both the national and international dimension investment policymakers via the creation of such interaction requires substantial understanding of the different objectives, functions and natures of the legal instruments involved. This is considered as crucial for countries aiming to create a mutually supporting, sustainable development-oriented investment policy regime. However, several challenges are argued to arise from the interaction between IIAs and the national legal framework for investment (UNCTAD, 2018):

- Policymakers in charge of national and international investment policies might be operating in silos and create outcomes that are not mutually supportive or, worse, conflicting.
- Incoherence (e.g., between a clearly defined FET clause in one or several IIAs and a broad FET clause in an investment law) may have the effect

of rendering IIA reform ineffective. Similarly, broadly drafted provisions in “old” IIAs risk cancelling out reform efforts in new, more modern investment laws.

- Incoherence between investment laws and IIAs may also create ISDS-related risks when national laws include advance consent to international arbitration as the means for the settlement of

investor-State disputes, which could result in parallel proceedings.

To maximize sustainable development benefits, the enhancement of synergies between IIAs and the national legal framework for investment need to be supported. UNCTAD (2018) describes several entry points for countries to address the challenges described above and to accomplish this (Table 5.5).



**Table 5.5** Entry points for maximizing synergies between IIAs and the national legal framework for investment

Strengthening cooperation between policymakers	<ul style="list-style-type: none"> <li>• Improve coordination between institutions charged with national and international investment policymaking.</li> <li>• Encourage consultation between the various stakeholders in the investment regime.</li> </ul>
Improving interaction between the two regimes	<ul style="list-style-type: none"> <li>• Establish clear principles for inter-operation of the different elements of the regimes.</li> <li>• Condition IIA protections on investors' compliance with domestic law, provided that such are in line international commitments.</li> <li>• Use divergence to pursue strategic policy objectives.</li> </ul>
Ensuring cross-fertilization between the two regimes	<ul style="list-style-type: none"> <li>• Determine where the national legal frameworks for investments can benefit from elements found in modern IIAs;</li> <li>• Determine where IIA negotiators can consider features common to national investment policy making.</li> </ul>

Source: UNCTAD, table III.7, page 109 (2018).

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.<sup>35</sup> 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. Sirm 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. Accordingly, Kerner (2019) states that the BITs capacity to catalyse long-term investment is central to their appeal but despite years of study, it is still not clear that they encourage investment. In this regard, Cavallo (2020) describes the case of Brazil. Which despite not ratifying any BIT, has experienced an increase in FDI flows and is thus used in the literature as an example that BITs do not present any major effects on FDI inflows, implying that countries can increase FDI inflows without them (Cavallo, 2020). Gaffney (2018) proposes however that BITs could be utilised to enhance access to human rights remedies in future BITs. This is achieved by having the host country make an open offer in a BIT to arbitrate with any foreign investor that falls within a defined category in that treaty. If a foreign investor wishes to commence arbitration, it solely has to accept the

<sup>35</sup> Columbia Center on Sustainable Investment, 'Extractive Industries' <http://ccsi.columbia.edu/our-focus/investments-in-extractive-industries/>

offer from the host country to constitute a binding arbitration agreement which includes requirements and conditions on human rights standards with the host country (Gaffney, 2018).

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. Generally, while IIAs can be a factor in FDI attraction, in the case of deeper and broader economic partnership agreements with substantive investment chapters, IIAs alone are never sufficient (UNCTAD, 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. 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.

## 2. Structure of International Investment Agreements

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 strife);
- 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** (Reinisch, 2013; Bernasconi-Osterwalder and Rosert, 2014; Sauvant, 2019; Babu, 2021).

## 3. Substantive Provisions in International Investment Agreements

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 (Fortier & Drymer, 2005). Such a wide definition puts limitations on governments to pursue legitimate development objectives.

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, both in the form of **most-favoured nation** clauses which call for equal treatment of foreign investors from all countries (Claxton, 2021), and **national treatment** clauses which call for equal treatment of foreign and national investors (Brar, 2021), 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 (Weeramantry, 2021). These standards of treatment are now under review as part of rebalancing the

rights of investors with legitimate development considerations for host governments. 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 (Babu, 2021).

With regard to non-discrimination clauses a distinction is made between **pre-establishment** and **post-establishment** of the investment (Wongkaew, 2021). 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. While a wide definition has implications for most other provisions, it also raises issues related to what constitutes FET. FET normally refers to issues like interference with rights (of the investor), denial of justice, and regulatory change (Weeramantry, 2021). 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 regarding the coverage of IPR, which is routinely emphasized as an important part of IIAs involving developed countries (Vanhonacker, 2021; Weeramantry, 2021). 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 (Marisi and Chaisse, 2019). 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.

#### 4. Dispute Settlement Provisions in International Investment Agreements

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. 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 (Reinisch, 2013; Echandi, 2020; Islam, 2021). SSDS is normally conducted by the International Court of Justice or regional courts (Bernasconi-Osterwalder, 2014; Qian, 2021).

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 (Sauvant, 2019; Qian, 2020; Islam, 2021; Sornarajah, 2021). 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. 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. 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.

In July 2014, UNCITRAL adopted the Mauritius Convention on Transparency that is expected to increase the transparency of investor-state arbitrations conducted under thousands of existing investment treaties and under any set of arbitration rules (Li, 2021; Marisi, 2021). 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.<sup>36</sup> UNCITRAL's Mauritius convention approach may be considered to create a permanent multilateral international tribunal for investments or an appeal mechanism. UNCTAD's Investment Dispute Settlement Navigator provides an excellent database on all outstanding international investment disputes (box 5.11).

Because of 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. 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.<sup>37</sup>

Since the Indian economy's liberalization in 1991, India has signed a number of Bilateral Investment Treaties, out of which some have come into force. However, by 2012, eleven disputes had emerged over the country's obligations under the different BITs, resulting in debates concerning a serious rethinking of the policy behind India's BITs (Dhar, Joseph, James (2012)).

Following the *White Industries v Republic of India*<sup>38</sup> case in 2011, India's stance on investment treaties began to shift dramatically. This dispute turned out to be an eye-opener for the Indian Government. This was because a number of foreign firms filed ISDS notices against India, challenging a variety of regulatory measures such as the imposition of retrospective taxes, the cancellation of spectrum licenses, and the revocation of telecom licenses (Ranjan, 2018). Inspired by the work of the UNCTAD on BITs and developments in countries like Latin America and Africa, the Ministry of Commerce released a discussion paper "International Investment Agreements Between India and Other Countries," which called for a review of existing BITs during 2011. This was further supported by many stakeholders, including academics, lawmakers, and civil society organizations. (Ranjan, 2015).

Specifically, based on the *White Industries* award and other ISDS notifications previously filed on India, India stated that the "current investment treaty regime... can be viewed as unfair for State's in the

<sup>36</sup> 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 European Commission; The Multilateral Investment Court project'. EC, 21 December 2016

<sup>37</sup> See Department of Economic Affairs, Ministry of Finance 'Model Text for the Indian Bilateral Investment Treaty' (2016) [https://dea.gov.in/sites/default/files/ModelBIT\\_Annex\\_0.pdf](https://dea.gov.in/sites/default/files/ModelBIT_Annex_0.pdf). See also Norton Rose, 'India releases a New Model BIT.' (NRF, 9 February 2016).

<sup>38</sup> *White Industries Australia Limited v Republic of India*, UNCITRAL, Final Award. 30 November 2011.



### UNCTAD's Investment Dispute Settlement Navigator

The UNCTAD Investment Dispute Settlement Navigator – the ISDS Navigator – is maintained by UNCTAD's IIA Section. The ISDS 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.

UNCTAD, Investment Dispute Settlement Navigator, available at <https://investmentpolicy.unctad.org/investment-dispute-settlement>

The ISDS Navigator is:

- Comprehensive: the world's most complete ISDS database containing information on 1061 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.
- 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: <https://investmentpolicy.unctad.org/investment-dispute-settlement>

Source: <https://investmentpolicy.unctad.org/investment-dispute-settlement>

exercise of their regulatory power." (Ranjan, 2014). Further, the existing BITs contained broad and ambiguous provisions capable of significant encroachment on State regulatory powers. Thus in 2012, the Central Government Working Group launched a review process with the goal of developing an investor-state dispute resolution regime that would balance investor rights with State regulatory obligations (Garg, 2016). Following the submission of comments and stakeholder concerns that the Model BIT might jeopardize foreign

investment entry, the Ministry of Finance unveiled the updated and final version of the Model BIT in January 2016. With its introduction, India has eschewed the extreme alternative taken by nations like South Africa of withdrawing from the system. It has instead altered the scope and content of several key provisions in the Model BIT to restrict challenges to its activities.

The formulation of the New BIT Model, started to develop from 2012 onwards owing to a few key developments. Heavy reliance was placed on

the Ministry of Commerce's discussion paper "International Investment Agreements Between India and Other Countries". The paper recognized that "when developing countries enter into BITs, a balance between investors' rights and domestic policy must be ensured." It was inspired by the work of the United Nations Conference on Trade and Development (UNCTAD) on BITs and developments in South Africa (Schlemmer, 2016) (Webb, 2016) (Sornarajah, 2015) and Latin America (Crockett, 2015). The discussion paper also stated that "other legitimate public concerns must not be subordinated to investment protection issues." It found a number of concerns with Indian BITs, including an extended definition of investment, an ambiguous fair and equitable treatment clause, a broad provision on expropriation with no reservations or exclusions, and a broad provision allowing investors to freely transfer funds. According to the study, these broad and unqualified BIT clauses might lead to scenarios in which India's regulatory authorities are jeopardized. The study stated that India should assess its current BITs and, if it decides to continue with BITs, foreign investors' rights should be balanced with India's regulatory authority to act in the advancement of public interests such as health and environmental preservation.

The asset-based approach of investment for instance has been adopted while referencing to the treaty practice adopted by US-Korea (2012), EU-Canada Comprehensive Economic and Trade Agreement (CETA) (2016), India-Korea (2009), and CPTPP Agreement. MFN Clause in India's model BIT has been completely excluded in light of the decision of *White Industries*. Further, some of the provisions specified in Article 8.10 of the EU-Canada CETA are also included in Article 3.1 of the Indian model BIT, which deals with the FET standard. Lastly, certain exceptions created for taxation measures are in response to claims launched by Vodafone and Cairn for keeping taxation measures outside the purview of BITs. The Model BIT also excludes from its scope the granting of compulsory licenses, provided that such issuance is compliant with the WTO treaty.

India's move to adopt a new Model BIT is to be applauded, especially in view of the rising discussion over how to combine investment protection with the host state's ability to regulate. India has now realized, as a result of foreign investors suing it under several BITs, that broad and ambiguous investment protection standards might be read in ways that

prioritize investment protection above the host state's power to regulate (Ranjan, Anand (2017)). The fact that India has established a new Model BIT that continues to allow foreign investors the opportunity to challenge India's regulatory actions under the BIT demonstrates India's ongoing participation with the ISDS system, in contrast to nations such as South Africa and other Latin American countries. India, on the other hand, has fundamentally altered the terms of this interaction.

The drafters of the 2003 Model BIT had overlooked (then) recent investment law cases arising from disputes between investor protection and regulatory regimes. *Metalclad Corp. v. Mexico* (local authority refused to give waste disposal permission)<sup>39</sup>, *S.D. Myers Inc. v. Canada* (government limited hazardous waste exports)<sup>40</sup>, and India's experience with the Dabhol Power Project had previously raised questions about the nature of India's BITs. As a result, the 2016 India Model BIT establishes a state-centric investment treaty framework and grants India substantial regulatory authority. As India strives to become the world's fastest-growing economy and moves into a higher band for ease of doing business, it is critical that it provides a strong framework for protecting investors and investments, as well as an effective means of resolving disputes between foreign investors and the Republic of India. It is critical to recognize that foreign investment has enormous potential to support economic growth and that regulation within its allowed boundaries is sufficient to oversee and control foreign investment. What India is looking for is a legal and regulatory framework that is not adversarial or difficult for foreign investors, but rather instills confidence and faith in order to foster smooth and beneficial economic relationships that lead to effective and sustainable development for both the foreign investor and India.

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.<sup>41</sup> UNCTAD's World Investment Report 2016 provides more details on new model IIAs (UNCTAD, 2016).

<sup>39</sup> *Metalclad Corporation v The United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award. 30 August 2000.

<sup>40</sup> *S.D. Myers Inc. v. Canada*, *SD Myers Incorporated v Canada*, UNCITRAL, Partial Award, 13 November 2000.

<sup>41</sup> See further IISD, 'Side-by-side Comparison of the Brazil-Mozambique and Brazil-Angola Cooperation and Investment Facilitation Agreements'; IISD, 'The Brazilian Agreement on Cooperation and Facilitation of Investments (ACFI): A New Formula for International Investment Agreements?' ITN, 4 August 2015.; Nathalie Bernasconi-Osterwalder and Martin Dietrich Brauch, 'Comparative Commentary to Brazil's Cooperation and Investment Facilitation Agreements (CIFAs) with Mozambique, Angola, Mexico, and Malawi.' IISD, September 2015.



### India BIT Model Key Provisions

There are seven key provisions in India's 2016 Model BIT:

1. **Definition of Investment:** In the 2016 Model BIT, India shifted from a wide asset-based definition of investment to an enterprise-based definition, in which a company is considered together with its assets. In the 2016 Model BIT, investment refers to an enterprise formed, organized, and operated in good faith by an investor in compliance with the country's domestic laws. Article 1.4 also includes a non-exhaustive list of assets that an enterprise may own. It further states that for investments to be made, the firm must meet specific criteria based on the Salini test.
2. **Most Favored Nation (MFN Clause):** It is worth noting that the MFN clause is absolutely absent from India's model BIT. This is due to the MFN Clause, which interferes with the various strategic, diplomatic, and political objectives for negotiating bilateral treaties.
3. **Fair and Equitable Treatment:** The FET provision is not included in the 2016 Model BIT. Owing to the broad interpretation of the FET clause, India chose not to incorporate one. Instead, the Model BIT contains a section provision headed 'Treatment of Investments.' under Article 3.1, which prevents a government from subjecting foreign investments to measures that violate customary international law 'via': denial of justice, which covers both judicial and administrative proceedings; or fundamental breach of due process; or targeted discrimination on manifestly unjustified grounds such as gender, race or religious belief or manifestly abusive treatment such as coercion, duress, and harassment.
4. **Expropriation:** Article 5.1 of the Model BIT forbids nationalization or expropriation, either directly or by measures with the effect of expropriation, except for public purposes, in compliance with due process, and on payment of sufficient compensation.
5. **Monetary Transfer Provisions:** The 2016 Model BIT acknowledges the investor's right to transfer any funds associated with an investment, such as capital contributions, earnings, dividends, interest payments, and so on. However, the investor's ability to move funds is limited by three factors. First, under Article 6.1, the investor's right to move funds is subject to the host State's domestic laws. Second, Article 6.3 of the 2016 Model BIT states for application of laws in good faith by the host state (i.e.,). Third, according to Article 6.4 of the 2016 Model BIT, temporary restriction in the investor's right to transfer money owing to major BoP issues or when it threatens to cause serious challenges for macroeconomic management.
6. **ISDS Mechanism:** In the 2016 Model BIT, India conditioned its approval to ISDS by requiring a foreign investor to exhaust domestic remedies for at least five years before resorting to international arbitration. This date is to be counted from the date when the investor acquired knowledge about the resulting loss or damage. Further, they are required to submit the dispute to a local court within one year after the investor's attainment of the knowledge. This requirement is not applicable if the investor can demonstrate that there was no available domestic legal remedy.
7. **General Exceptions:** A separate chapter in the 2015 Model BIT covers both general and security exceptions. Article 32 contains general exceptions with a long list of permissible objectives, including the protection of public morals, the maintenance of public order, the protection of human, animal, or plant life or health, the protection and conservation of the environment, and ensuring compliance with domestic laws that are not inconsistent with the treaty's provisions.
8. **Other Exceptions:** Aside from the general exclusion provisions, Article 2 of the 2015 Model BIT expressly excludes certain regulatory measures from the scope and coverage of the treaty while detailing the scope and coverage of the treaty. Two of which include laws or measures relating to Taxation and issuance of Compulsory licensing.

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 5.13 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 to these ways.

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. The first is a positive/negative list. According to this suggestion, countries can enhance their policy space to opt for positive rather than negative lists when defining the scope of a provision



### 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.
- **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](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>.

or even a term. 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.

With respect to 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, India-Bangladesh BIT (2009)).

Indirect expropriation are State measures that can substantially deprive 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.<sup>42</sup> See for instance annex II of ACIA, article 13 of the ECT.

Other than this, 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". This is similar to an exclusions clause which is also often found in IIAs or Model BITs. Examples include NAFTA Chapter XXI Article 2102, ECT Article 24, Canada Model BIT (Article 10). International law also excludes a State's responsibility for breaching its international obligations in cases of "necessity", which is another manner to frame this clause. 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.

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. Another such principle is the margin of appreciation, according to which States are 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.

The UNCTAD Investment Policy Framework for Sustainable Development also provides suggestions to enhance policy space and make IIAs more aligned with achieving the SDGs.<sup>43</sup> An important recommendation of the UNCTAD is to create IIAs that have provisions keeping sustainability and sustainable development at the forefront. These are extremely important and can be incorporated through State's regulatory rights, demarcating rights and obligations of both parties etc. this can also be done by duly incorporating IIAs into the development strategy and policy goals of the country.

In any case, the increase of BITs is slowing with the rapid increase in free trade agreements that contain comprehensive investment chapters. Of recent interest (or concern) is the Trans-Pacific Partnership (TPP) Agreement and its evolution into the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) in 2018. The CPTPP contains deep commitments on investor protection, in particular with regard to ISDS (Qian, 2020). Similar provisions may enter the Regional Comprehensive Economic Partnership Agreement (RCEP) as it evolves in the years after entering into force in 2022 (Chaisse 2020). (see section E of this chapter for more on both regional agreements) Other earlier examples include the ASEAN-China Investment Agreement and the ASEAN Comprehensive Investment Agreement or ACIA (Chaisse and Jusoh, 2016; Schacherer, 2021).

## 5. UNCTAD's Road Map for international investment agreements reform

UNCTAD has first provided policy guidelines for negotiating IIAs under its Investment Policy Framework for Sustainable Development (IPFSD). In UNCTAD's World Investment Report 2015, these guidelines were updated under its Road Map for IIA Reform (UNCTAD, 2015b). In the Report, it is argued

<sup>42</sup> Bonniticha J, "Indirect Expropriation," *Substantive Protection under Investment Treaties: A Legal and Economic Analysis*. Cambridge University Press 2014.

<sup>43</sup> UNCTAD, 'Investment Policy Framework for Sustainable Development' UNCTAD, 2015.

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 particular 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.).

In 2018 UNCTAD launched the updated version of UNCTAD's Reform Package for the International Investment Regime (UNCTAD, 2018). See also: High-level IIA Conference on 24 October 2018, during UNCTAD's World Investment Forum 2018. In November 2020, UNCTAD released the IIA Reform Accelerator which aims to expedite the modernization of the existing stock of 2,500 old-generation IIAs presently active. While the number of treaty-based ISDS cases continues to grow, the reform of such old-generation treaties has not taken off on a large scale, giving the rise to the need of the reform of such old-generation treaties. Thereby reducing the risk of ISDS cases against State measures as efforts of reaching legitimate public policy objectives. Therefore, the Accelerator responds to the need of reform of eight key IIA provisions which have seen a clear reform trend and are in line with SDGs and towards safeguarding the State's right to regulate in IIAs. The Accelerator tools identifies for each provision sustainable development-oriented policy options and proposes ready-to-use model language that implements these options. Moreover, the reform-oriented formulations can be directly used at the national, bilateral, regional and multilateral level with a view to interpret, amend or replace old-generation treaties (UNCTAD, 2020).

Consolidated into one comprehensive Reform Package, UNCTAD makes available a coherent, sequenced and user-friendly set of options for countries engaging in sustainable development oriented IIA reform. This comes at a time when IIA reform has entered the mainstream of international investment policymaking. The updated Reform

Package combines the research and policy analysis from the World Investment Report 2015 (the Road Map for IIA Reform), the World Investment Report 2017 (the 10 Options for Phase 2 of IIA Reform) and the World Investment Report 2018 (the guidance for Phase 3 of IIA Reform) into one single document:

- IIA Reform: Rationale and Strategic Considerations
- General Guidelines for IIA Reform
- Phase 1 of IIA Reform: Moving to a New Generation of IIAs – This section broadly assesses the standards of treatment generally provided in IIAs and provides options to reform these standards, by ensuring that there is a balance taking care of interests of both the foreign investors and host State. It identifies 5 priority areas for reform and proceeds accordingly.
- Phase 2 of IIA Reform: Modernizing the Existing Stock of IIAs – This section briefly traces the difference between “older” and “new” BITs in terms of their definitions and features, in order to determine whether there is a need of reforming the “older” IIAs. It also discusses the impact of these reform options on these treaties and potential positive and negative implications of such actions. In effect, it concludes by providing policy options.
- Phase 3 of IIA Reform: Improving Investment Policy Coherence and Synergies – This section is premised on the idea that merely reforming IIAs will not help until domestic policy areas and other legal instruments work in tandem with these reforms. It discusses major challenges to these coherence-specific measures and suggests appropriate solutions.

UNCTAD's Reform Package (2018 edition) is the result of a collective effort, led by UNCTAD, pooling global expertise in the investment and sustainable development field from international organizations and numerous international experts, academics, business, practitioners and other stakeholders in the field of investment law and policy. It has been designed as a “living document” for regular updates, in light of the new developments and advocacy for reform, with a standing invitation to the international community to exchange views, suggestions and experiences. The aim of this document is to help create comprehensive regime reform by providing a one-stop shop solution to address the different fragments to enable this change. Importantly, however, it focuses on sustainable development being emulated through such reform and ensuring that majority Sustainable Development Goals (SDGs) are implemented in practice. By undertaking a three-phase analysis, and in a concerted manner

across countries, this document aims to serve as a policy tool for the future developments in national investment laws and regional and international regimes generally. This document has received critical appraisal from policymakers worldwide as well.

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 among others. 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.

## 6. Guidelines for IIA Reform

IIA reform should be guided by the goal of harnessing IIAs for sustainable development, focusing on key reform areas, and following a multilevel, systematic, and inclusive approach. The Six Guidelines for IIA Reform guide any reform action, be it undertaken at the national, bilateral, regional or multilateral levels. Inspired by the UNCTAD Investment Policy Framework's Core Principles, these Guidelines aim at harnessing IIAs for sustainable development:

1. **Harness IIAs for sustainable development.** The ultimate objective of IIA reform is to ensure that the IIA regime is better geared towards sustainable development objectives while protecting and promoting investment.
2. **Focus on critical reform areas.** The key areas for reform are (a) safeguarding the right to regulate for public interest, (b) reforming investment dispute settlement, (c) strengthening the investment promotion and facilitation function of IIAs, (d) ensuring investor responsibility, and (e) enhancing systemic coherence.
3. **Act at all levels.** The reform process should follow a multilevel approach and take place at the national, bilateral, regional, and multilateral levels, with appropriate and mutually supportive action at each level.

4. **Sequence properly for concrete solutions.** At each level, the reform process should follow a gradual, step-by-step approach, with appropriately sequenced and timed actions based on identifying the facts and problems, formulating a strategic plan, and working towards concrete outcomes that embody the reform effort.
5. **Ensure an inclusive and transparent reform process.** The reform process should be transparent and inclusive, allowing all stakeholders to voice their opinion and to propose contributions.
6. **Strengthen the multilateral supportive structure.** The reform process should be supported by universal and inclusive structures that help coordinate reform actions at different levels by offering backstopping, including through policy analysis, technical cooperation, and a platform for exchange of experiences and consensus building (Source: UNCTAD, 2018).

In addition to this, the following five priority areas for reforming IIAs should be considered:

1. **Safeguarding the right to regulate.** While IIAs contribute to a favourable investment climate, they inevitably place limits on contracting parties' sovereignty in domestic policymaking. Given the rising concerns that such limits go too far, especially if combined with effective enforcement, IIA reform needs to ensure that countries retain their right to regulate for pursuing public policy interests, including sustainable development objectives (e.g., for the protection of the environment, the furtherance of public health or other social objectives) Safeguarding the right to regulate may also be needed for implementing economic or financial policies. At the same time, however, policymakers must be vigilant that providing the necessary policy space for governments to pursue bona fide public goods does not inadvertently provide legal cover for investment protectionism or unjustified discrimination.
2. **Reforming investment dispute settlement.** Originally modelled on the system of ad hoc confidential commercial arbitration between private parties, today, the ISDS system suffers from a legitimacy crisis. There are concerns that the current mechanism exposes host States to additional legal and financial risks, often unforeseen at the point of entering into the IIA and in circumstances beyond clear-cut infringements on private property, without necessarily bringing any benefits in terms of



additional FDI flows; that it grants foreign investors more rights as regards dispute settlement than domestic investors; that it can create the risk of a “regulatory chill” on legitimate government policymaking; that it results in inconsistent arbitral awards; and that it is insufficient in terms of ensuring transparency, selecting independent arbitrators, and guaranteeing due process. IIA reform needs to address these concerns.

3. **Promoting and facilitating investment.** Promoting and facilitating investment is crucial for achieving the 2030 Agenda for Sustainable Development. However, the majority of existing IIAs does not include efficient investment promotion and facilitation provisions and reserve this issue for domestic policymaking. A third reform objective, therefore, is to expand the investment promotion and facilitation dimension of IIAs together with domestic policy tools and to target them towards foreign investment capable of promoting sustainable development.
4. **Ensuring responsible investment.** FDI can make positive contributions for development, but it can also negatively impact the environment, health, labour rights, human rights or other public interests (UNCTAD, 2014). Typically, IIAs set out few, if any, responsibilities on the part of investors in return for the protection that they receive. One objective of IIA reform therefore is ensuring responsible investor behaviour. This includes two dimensions: maximizing the positive contribution that investors can bring to societies (“doing good”) and avoiding negative impacts (“doing no harm”).
5. **Enhancing systemic consistency.** The atomized, multifaceted, and multi-layered nature of the IIA regime gives rise to gaps, overlaps and inconsistencies, between IIAs, between IIAs and other international law instruments affecting investment, but also between IIAs and domestic policies. IIA reform therefore should seek coherence in these various relationships. This is a reform objective that is relevant both in terms of content, the “what”, but also in terms of process, the “how” of IIA reform. Accordingly, it is here where the three phases of IIA reform interact, and at times overlap, most

## 7. COVID-19, IIAs and ISDS

International Investment Tribunals may be called upon once again to assess states’ responses to the COVID-19 epidemic. Some measures may have been effective in achieving their claimed goals, while others may have merely harmed companies. Tribunals will therefore have to carefully examine the actions made in the light of a pandemic emergency that occurred.

In this regard, four major conceptually distinct types of measures can be identified (Chaisse 2020a): first, the States’ measures that affect the “operating conditions” of foreign investors; second, the States’ measures that take the form or have the effect of “trade and market access restrictions”; third, the measures taken by States that have the potential to interfere with or affect “due process”; and finally, a number of measures that only indirectly impact foreign investors.

Foreign Investors Operating Conditions refer to a collection of conditions, specifically regulatory frameworks, for running a certain company/ investment. Many states have implemented steps to deal with the COVID-19 pandemic, which have the potential to change the way businesses create goods and provide services both locally and globally (Ranjan & Anand 2020). Many initiatives relate to the suspension of utility payments, which refers to the government suspending the bills that people pay for utilizing utilities like electricity, water, and gas. Governments are the regulating authority over the companies that conduct such transactions. Peru and El Salvador are the few countries that imposed such measures amongst others during the pandemic. Under the Second type of measure, it encompasses various export controls, price controls, and Other Trade Measures.

Due process and procedural irregularities are wide categories that encompass the problem of private property seizure, which refers to the government seizing/taking over another person’s/private company to meet needs that the state lacks. (In order to combat the coronavirus, China ordered the confiscation of hotels, hospitals, and automobiles.) The idea of due process issues and procedural irregularities encompasses the subject of Court closure and the extraordinary power of government. Lastly, other measures that indirectly impact investment in the business sector include tax and sovereign debt.

Some of the policies taken by various governments have already generated worries about whether they may result in a flood of new foreign investment claims. Peru, for example, was apparently threatened by an investment claim in April 2020. Peru’s Congress adopted a law prohibiting the collecting of tolls on important roadways as one of the numerous measures taken to curb the country’s COVID-19 outbreak. There will be legal wrangling since not all COVID-19 measures were successful, and not all were implemented at the same time or with the same emphasis on scientific evidence. Furthermore, the disruption to supply chains and consumer preferences would leave long scars on international trade, implying that some enterprises may not be impacted

immediately, but rather much later. The time lag will complicate the evaluation of investors' operations even more (and possibly bankruptcies). It is also clear that the COVID-19 situation cannot be used to justify all new laws and regulations imposed in many nations. In certain cases, the crisis may have prompted governments to take inappropriate tactics. Given the enormous number of territories impacted by the epidemic, governments have taken a variety of measures to manage the health catastrophe, which will undoubtedly pose a number of problematic concerns, particularly under investment treaties.

The first actual ISDS claim relating to government responses to the pandemic is that of two French airport operators bringing an ICSID claim against Chile – filed on 13 August 2021 – in response to Chile's refusal to renegotiate concession terms with them after the investors' profits fell by 90 per cent in 2020. The French concessionaires' lawsuit under the 1992 Chile–France BIT seeks compensation for net losses of US\$37 million in 2020, as well as contract revision to avoid their investment from being expropriated. The consortium operators say that revenues fell by 90 per cent in 2020, as Chile has lost 19 routes and 630 weekly frequencies since the pandemic began, resulting in a 70 per cent decline in passenger counts. The controversy erupted after the Chilean Ministry of Public Works denied the consortium's request for financial assistance and a concession extension in order to restore its economic viability and recover the investment made in the new terminal now under construction. Such a possibility cannot be ruled out given previous examples wherein nations faced ISDS claims when they implemented emergency regulatory measures to address the issue at hand. In the 2000s, for example, multiple ISDS cases were filed against Argentina, questioning the country's economic emergency measures in response to a severe economic crisis. Similarly, when it took efforts to stop the anti-government rallies and violent rebellions that swept much of the Arab world in the early 2010s, Egypt faced similar ISDS claims (also known as the Arab Spring). (Ranjan, Anand (2020))

To address investment claims, every IIA must include a provision for dispute resolution. Arbitration is one of the conflict resolution procedures. Parties in the investment sector have the option of resolving investment disputes through the ICSID or another kind of arbitration, such as institutional and ad hoc arbitration. Many COVID-19 measures will be challenged before investment tribunals by states. Despite the fact that numerous nations have signed IIAs, particularly BITs, they always have certain characteristics. Every investment treaty includes the following provisions: definition and extent of

application, admission of the investment, national treatment, most favored nation, fair and equitable treatment, expropriation, and dispute settlement.

Other elements of IIAs that have a direct impact on the amount of protection afforded to foreign investment include full protection and security, national standard of treatment, most-favored-nation treatment, and the so-called umbrella clause. Additional clauses that are commonly used are those that refer to the standard of protection provided in situations of emergency, necessity, armed conflict, and force majeure; guarantees of access to justice, fair procedure, and protection against denial of justice; and clauses covering the import and export of goods. All of these provisions may play a part in COVID-19-related investment conflicts. IIAs frequently contain requirements for fair and equitable treatment and expropriation. Furthermore, Investment treaties in particular also contain carefully worded special clauses stating that even though parties have taken into treaty commitments, such commitments do not preclude them from adopting actions to preserve their national security interests. These are referred to as treaty-based essential security exceptions.

Not many states may have been transparent about the epidemic, which will influence their obligations under investment treaties. Tribunals may be required to examine the legality of measures implemented in light of investment treaties, as well as their appropriateness in reducing the effects of the epidemic. In doing so, the tribunal will have to take into account international health rules and epidemic management, state policies, and limited (or, more specifically, rapidly growing) scientific data, in addition to the parties' arguments. Although it is not unthinkable that violations of IIAs may be discovered, investment treaty clauses will play a critical role.

## E. Regional cooperation and integration, and FDI

Regional cooperation or integration can help countries achieve synergies in attracting FDI through common collaboration frameworks that 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 can 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. Increasingly, RTAs contain specific chapters or provisions on investment as well as on IPR and services, which cover investment directly. Those provisions may strengthen the investment climate in all RTA members. However, while RTAs may lead to more intra-group FDI, they may not necessarily attract more FDI from non-RTA members.

In addition, RTAs often contain provisions on the movement of capital and labour that are potentially attractive to investors. 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 aim at levelling the playing field. This explains why many non-members of blocs such as ASEAN and NAFTA were eager to conclude FTAs with the leading members of these blocs or the bloc as a whole. This is particularly the case in ASEAN, 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 those 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 gain 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 that are open to members only. As RTAs or regional integration agreements in a wider sense differ extensively 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.

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 the most positive impact on FDI 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 increased 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 that 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 attracting 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.

In general, 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) argued, 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 found 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 was an increase in inward FDI in host countries that were members of an RIA. They noted 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).

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, while cooperation mechanisms

may not directly target FDI they still have an impact on the attraction of FDI. For example, Aldaba and Yap (2009) found that regional financial cooperation in ASEAN was more important than regional financial integration and that it 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) pointed to the importance of the ASEAN industrial cooperation schemes and cooperation in investment facilitation by providing information through portals, databases, publications and databases.

New mega trade agreements, in particular the Regional Comprehensive Economic Partnership Agreement (RCEP) and the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), together with ongoing international and regional discussions on investment facilitation for development, can help to deepen the breadth and scope of regional integration efforts on investment while also boosting sustainable FDI.<sup>44</sup> Both the RCEP and CPTPP mega-trade agreements include important investment provisions. The RCEP has a comprehensive chapter on investment, ranging from a most-favoured nation clause, national treatment provisions, security provisions granting legal and administrative proceedings, the prohibition of performance requirements, shall-clauses for fair and equitable treatment as well as transparency and disclosure requirements. The RCEP is already boosting investor confidence and, once in effect, is expected to significantly bolster investments among signatories and the region. The chapter does not provide any provisions on investment protection or non-discrimination. More specifically, it does not include investor-state dispute settlement mechanisms; however, RCEP Parties have agreed to review this after five years after the Agreement has entered into force. Several other chapters in the Agreement will also indirectly affect investment, such as those on trade-in-goods, trade-in-services, e-commerce, other rules and disciplines, and economic cooperation.

Compared to RCEP, CPTPP in particular aims for stricter common standards on labour rights, environmental protection and investment dispute resolution. The inclusion of the investor-state dispute mechanism in the Agreement is the most noteworthy difference in the investment chapter of CPTPP compared to RCEP (except for New Zealand for whom these provisions will not apply). Beyond this, the CPTPP investment chapter also provides provisions for, inter alia, national treatment, most-favoured nation clauses, performance requirements, minimum standards of treatment, expropriation and compensation, and capital transfers. Policy space and flexibility has also been incorporated into the Agreement through reservations referred to as “non-conforming measures” that allow Parties to the Agreement to maintain exceptions to the CPTPP services and investment chapters in particular.

Other regional frameworks on investment in the region include the ASEAN Comprehensive Recovery Framework, which aims to promote sustainable and responsible investment for improving resilience from future shocks. ASEAN also adopted the ASEAN Investment Facilitation Framework (IFF) in October 2021 to expedite and streamline investment procedures in ASEAN countries.

At the global level, more than 110 countries have been involved in negotiating a multilateral investment facilitation for development agreement within the context of the WTO. Driven by developing countries, negotiations began in 2020, and since then much progress has been made. From the outset, negotiating parties agreed to exclude issues related to market access, investment protection and investor-state settlement dispute. Instead, the Agreement focuses on procedural issues that aim to improve the transparency and predictability of investment regimes, streamline administrative procedures for investment and enhance cooperation between stakeholders. The Agreement also aims to have a built-in capacity-building element to help signatory countries implement investment facilitation measures to align with the Agreement. Should the Agreement be reached, it stands to significantly boost FDI flows globally, but especially in developing countries.

<sup>44</sup> International and regional efforts to conclude agreements with investment facilitation for development provisions are elaborated in Part III, chapter 10 on investment facilitation and aftercare.



### RCEP and sustainable FDI

The Regional Comprehensive Economic Partnership Agreement in particular is expected to strengthen flows and lift investment prospects for signatory countries, especially smaller and least developed countries in the group such as Cambodia, Myanmar and the Lao People's Democratic Republic. Although more than 70% of the investment into these countries already comes from other RCEP members, the Agreement – which came into force in 2022 – could nonetheless help them to more effectively integrate into, and move up in regional and global value chains.<sup>45</sup> It offers a viable opportunity to lift investment prospects for signatory countries to build forward better and more sustainably through the complementary competitive and locational advantages among signatory countries, and through strengthening intraregional investments in key SDG priority sectors. Signalling this, already nearly 70% of cumulative FDI projects in RCEP countries between 2015–2019 were in SDG-related sectors, such as infrastructure, renewable energy, water and sanitation, health care, food and agriculture, and education.<sup>46</sup>

Importantly, provisions within the RCEP agreement can contribute to enhancing sustainable investment opportunities. This includes provisions both in the investment chapter as well as those related to investment in several other chapters of the Agreement.<sup>47</sup> Two unique features warrant further consideration: (1) RCEP is a 'living' document, and its details, including provisions and signatory countries, can improve over time, leaving considerable scope for incorporating more sustainable development oriented provisions within it; and (2) the provision on investment facilitation in the investment chapter of RCEP could enable signatory countries to better target FDI for sustainable development.<sup>48</sup> ESCAP (2022) analyses the substantive provisions within the RCEP investment chapter to identify how they can contribute to achieving sustainable development among signatory countries. It finds that while provisions in the RCEP investment chapter could help countries achieve the SDGs and boost sustainable FDI to signatory countries, the extent to which it will do so depends largely on the willingness and capacity of signatory countries to implement the provisions within the Agreement at the national level.

The ESCAP report also notes that RCEP also has the potential to offer signatory countries a collaborative framework for cooperation on sustainable investment facilitation. Under RCEP they can exchange information on sector-specific best practices for sustainable investment, and share information on national rules and procedures as well as experiences. Furthermore, they can organize capacity-building and technical assistance, especially for the least developed countries in the RCEP region. Investment facilitation under RCEP follows a programmatic approach. In other words, RCEP provides flexibility for national regulation on investment facilitation, and this enables countries to target quality investment according to their national, social, economic, and environmental needs and priorities. Yet the common objective of all national investment facilitation efforts in the RCEP region should be to fill the important investment gap for achieving the sustainable development goals.

*Sources:* ESCAP, 2022 (forthcoming); RCEP and Sustainable FDI; ARTNeT on FDI Working Paper Series No.3.

## F. Summary: Most important policy lessons for sustainable FDI

This chapter dealt with policy and legal frameworks to attract 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 represents the

<sup>45</sup> UNCTAD, 2020, *Global Investment Trends Monitor*, November 2020, No. 37. United Nations publication. Available at <https://unctad.org/webflyer/global-investment-trend-monitor-no-37-special-rcep-agreement-edition>

<sup>46</sup> Ibid.

<sup>47</sup> Including trade in goods, trade in services, e-Commerce, and other rules and disciplines.

<sup>48</sup> This latter point is particularly relevant in the context of ongoing investment facilitation for development discussions within the WTO, but also within APEC.

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. Therefore, 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 FDI should preferably 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 is a summary for policymakers, when developing a sustainable FDI policy, of some of the important considerations required in formulating policies to attract FDI and benefit from it within the wider context of achieving sustainable development (as defined by the SDGs):

- 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, or any combination, of the following:
  - Access foreign technologies and skills;
  - Close the domestic savings-investment gap;
  - Close balance-of-payment deficits;
  - Close government budget deficits;
  - Provide domestic employment;
  - Undertake privatization in an environment of a weak domestic private sector;
  - Stimulate domestic competition and, thereby, competitiveness;
  - Improve sustainable business practices;
  - Develop domestic infrastructure under public-private partnerships;
  - Gain or expand access to foreign markets;
  - Allow domestic SMEs and other domestic enterprises to effectively integrate into regional or global value chains.

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 example, while FDI may be attracted to

generate employment, other policies, such as trade, education, agricultural, social and enterprise (SME) development policies, would also contribute to employment generation. Therefore, FDI needs to be properly placed in a wider development strategy for any given objective as detailed below.

- **Conform to the SMART principle.** Any objective of any policy needs to be (see, for example, UNCTAD, 2015):
  - Specific. Target a specific area for improvement. Identify specific types of FDI for targeting, and specify locations where FDI needs to be attracted. Further specifications should identify the country and company that should be targeted.
  - Measurable. Quantify or at least suggest an indicator of progress for monitoring and evaluation, i.e., the progress towards achieving the objective should be 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 that 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 example.
  - 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 before 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.** This should include 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.** This is necessary for assessing 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, and chaired by the Head of Government, should perform such a coordination role with due authority (see chapter 6 for a more elaborate discussion). An IPA is normally not suited for such a role, as its main role 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 also lack other essential determinants for FDI.
- **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 as well as innovative policies and needs flexible labour laws, strong education and training systems, and flexible entry of foreign workers and 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 and 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, and in particular those that are less/least developed or landlocked.
- **Improve ease of doing business and cut out 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 ensuring that countries not only 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 6. 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.
- **Strengthen 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.
- **Improve institutional effectiveness.** This is a prerequisite for improving the investment climate. As Dupasquier and others (2012) noted, 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.
- **Engage in active and pro-active investment promotion and targeting** which play an important role in attracting FDI (see Part III of this Handbook). 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.** This is necessary to maximize benefits from FDI. In particular, the development of SMEs and forging of effective backward and forward linkages with MNEs 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 fast 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:<sup>49</sup>
  - Anti-competitive practices by foreign affiliates;
  - Volatile flows of investment and related payments deleterious to 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.

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<sup>49</sup> These areas were first identified by UNCTAD, 2003.



## G. Discussion questions

1. 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?
2. Do you consult the private sector, and in particular foreign investors, in formulating FDI policies or policies that have an impact on 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?
3. 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?
4. 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?
5. 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?
6. 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?
7. Does your country have any policy to promote the adoption of responsible business conduct/practice or CSR?
8. How do you view the contribution of FDI to individual SDGs and what could you do to strengthen that contribution?
9. Does your country have a specific foreign investment or investment law? Does your country discriminate between foreign and domestic investors?
10. Does your country have a negative or positive list approach to allowed sectors?
11. What land, property and investment ownership restrictions does your country have on foreign investment? Are these restrictions right, too strict or too flexible?
12. How do you rate your overall rule of law in terms of (a) adequate legal protection for foreign investors, and (b) due enforcement? Does your country have a national court and dispute settlement system that meets international standards and expectations?
13. What other laws does your country have that affect or have an impact on foreign investors and their investments? For example, 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?
14. 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?
15. How many IIAs (in particular BITs) is your country a contracting party to? Do you think these IIAs have helped to attract FDI? If so, are they overall or only in specific sectors?
16. 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?
17. 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?
18. How do you view the relationship between your national legislative framework for FDI and (a) your bilateral and regional legal commitments (under IIAs and RTAs), and (b) multilateral commitments (under relevant WTO laws)? Is there proper alignment? At what level do you think FDI should be best regulated – at the national, bilateral, regional or global (multilateral) level?



## CHAPTER



# Performance requirements, incentives and linkages

## A. Definition, rationale and objectives of performance requirements

Performance requirements are “stipulations, imposed on investors, requiring them to meet certain specified goals with respect to their operations in the host country” (UNCTAD, 2003). Performance requirements are 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 to 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 1 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.

Since there might be negative economic consequences from performance requirements, some international regulations have also prohibited some kinds of requirements. These have been categorized as shown in table 6.1.



**Table 6.1** Categories of performance requirements

Category	Performance requirement
Prohibited by the WTO Trade-Related Investment Measures (TRIMS) Agreement.	<ul style="list-style-type: none"> <li>• Local content requirements;</li> <li>• Trade balancing requirements;</li> <li>• Foreign exchange restrictions;</li> <li>• Export restrictions;</li> <li>• Quantitative restrictions;</li> <li>• Requirements that violate national treatment.</li> </ul>
Prohibited, conditioned or discouraged by international investment agreements at the bilateral or regional level.	<ul style="list-style-type: none"> <li>• Requirements to establish a joint venture with domestic participation;</li> <li>• Requirements for a minimum level of domestic equity participation;</li> <li>• Requirements to locate headquarters of a TNC in a specific region;</li> <li>• Employment requirements;</li> <li>• Export requirements;</li> <li>• Restrictions on sales of goods or services in the territory where they are produced or provided;</li> <li>• Requirements to supply goods produced or services provided to a specific region exclusively from a given territory;</li> <li>• Requirements to act as the sole supplier of goods produced, or services provided;</li> <li>• Requirements to transfer technology, production processes or other proprietary knowledge;</li> <li>• Research and development requirements;</li> <li>• Requirement to source a minimum of inputs required for the production of a good from local suppliers.<sup>1</sup></li> </ul>
Not restricted.	All other performance requirements (e.g., training, CSR, mandatory capital investments).

Source: UNCTAD, 2003.

<sup>1</sup> The WTO-Trade Related Investment Measures (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. Furthermore, some newer forms of local content requirements, such as those related to data storage and analysis, are not governed TRIMS (or the GATS Agreement) and therefore escape WTO discipline. With little WTO jurisprudence, it is unsurprising that both more traditional and newer forms of such requirements have proliferated in the aftermath of the global financial crisis which have profoundly impacted international trade and investment.

## 1. Do performance requirements work?

The use of performance requirements and their impact is closely linked to the perception of FDI in development. For example, while it is sometimes argued that performance requirements can be used as tools to address market failure, they also have the potential to create more market distortions and cause firms to behave differently than how they would have 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 are often those with less conducive investment climates, and performance requirements become an additional obstacle for investors. Countries with a superior investment climate do not need performance requirements, as the relatively high quality of the national legal and regulatory framework and domestic enterprises ensures that FDI does indeed contribute to development. However, a case can be made for linking performance requirements as a condition for receiving incentives, and the two concepts have become increasingly interlinked (Collins, 2015).

With regard to specific types of performance requirements, the evidence is also mixed but generally tends to be negative. For example, Hufbauer and others (2013) found that 117 new local content requirements (LCRs) were introduced between 2008 and 2013 globally, and caused a US\$93 billion reduction in international trade. Meanwhile, Stone and others (2015) found that between 2008 and 2015, the Governments in 39 countries imposed 146 new LCRs to boost employment and industrial performance. Using the OECD METRO trade model, that study concluded that LCRs “have caused a decline in global imports and exports in every region” and have been significantly damaging to global value chains as 80% of reduced trade caused by LCRs has been in intermediates. In yet another study, the Global Trade Alert documented the implementation of more than 340 new localization measures, mostly in “electrical machinery and equipment including telecommunications equipment, and vehicles” and “another 371 state purchasing regulations or decisions...requir[ing] some form of local sourcing” since 2008 (Evenett and Fritz 2016).

Proponents of LCRs highlight the fact that such requirements can increase foreign investment and help developing countries to protect and strengthen their indigenous industries that are otherwise unable to compete in world markets. They further contend that LCRs are important for expanding local

production and employment and encouraging technology transfers. Richardson (1993) employed a two-stage general equilibrium model of foreign capital flows and concluded that LCRs induce inward FDI because foreign firms are encouraged to increase their local production. Using a partial equilibrium model to analyse the optimal LCR-profit tax policy mix to attract FDI, Lahiri and Ono (1998) concluded that LCRs may have a positive impact on employment and price levels. However, they also noted that the optimal policy mix to attract FDI is very much dependent on “the number of domestic firms in the host country and their relative efficiency”. Veloso (2006) found that LCRs, if reasonably formulated to induce favourable economies of scale and promote local competition, can be welfare enhancing. Taking the case of the automotive sector, Veloso demonstrated that LCRs can be effective if they meet two conditions: (1) there is only a small gap in the manufacturing conditions for those components that are required to be produced locally; and (2) localization is linked to learning processes.

Johnson (2016) argued in a more recent study that LCRs may in fact have a role to play in achieving the SDGs. In particular, the author analysed the extent to which LCRs may potentially contribute to the attainment of Goal 8 on inclusive and sustainable growth and productive employment, Goal 9 on infrastructure, industrialization and innovation and Goal 10 on reducing inequalities. Recognizing the complexity and depth of the arguments for and against LCRs, the author concluded that if “properly designed and implemented, and complemented by an appropriate domestic enabling environment and absorptive capacity, local content policies can form an important part of Governments’ strategies to achieve their sustainable development objectives” (Johnson, 2016).

In general, performance requirements, in all their forms, have been hotly debated for several decades. Yet while they may be a tool aimed at generating investment, relatively little work has actually been done to assess the impact of LCRs on FDI specifically. Instead, the work that has been done in this area (see, for example, Qui and Tao, 2001) has very narrowly focused on the optimal policy design. Thus, questions about whether performance requirements really do generate increased investment and whether these increases are sustainable are often left unanswered. The lack of focus on FDI specifically is, in part, because performance requirements have much broader impacts on local economies than just on investment. This is further complicated by the fact that assessing and quantifying the “impact” of a performance requirement on investment is

challenging, as not only the availability of consistent and reliable FDI data is an issue, but there is also no one-to-one ratio between an LCR and a reduction or improvement in investment (Hufbauer and others,

2015). Boxes 6.1, 6.2 and 6.3 illustrate some examples of local content requirements, in particular, that have been implemented in Asia-Pacific.



**Box  
6.1**

**India's liberalization and local content requirements for FDI in multi-brand retail**

India has generally protected its domestic industry, particularly 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 delay. The principal reason for the delay was fear that foreigners would dominate retail trade and crowd out domestic SMEs, leading to unemployment and poverty.

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 US\$100 million; a 50% investment in back-end infrastructure (distribution centres, warehousing and logistics) within three years; and a 30% mandatory procurement of products sourced from small industries. Foreign investors would automatically source from local suppliers if the products fit their quality requirements, as sourcing locally is by definition cheaper than imports. However, if local suppliers do not meet these quality requirements, then foreign investors cannot risk undermining their global brand reputation. They would prefer not to invest at all. Furthermore, 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 while liberalizing some of its provisions. For example, foreign retailers are now allowed to open stores in cities that have a population of less than one million. Sourcing requirements were also slightly relaxed. At the same time, however, the Government tightened control on foreigners of joint ventures.

Various studies have indicated that liberalization of FDI in retail poses no problem for India (Singh, 2013). Indeed, recent research does not identify detrimental effects and still predicts further FDI would lead to better infrastructure, better quality products for consumers, upgrading of domestic suppliers, better logistics and less wastage of food products. Evidence from India and other countries seems to support this. As supermarkets are still only allowed in bigger cities in India, they do not pose direct competition to mom-and-pop stores that have been subject of the most pressing criticism. In fact, Walmart has launched a Mera Kirana programme supporting, modernizing and connecting mom-and-pop stores, for example (Lama, 2019). Moreover, experiences in other countries have also shown that although FDI in retail can have a disruptive effect, the impact has been limited (Reardon and others, 2012). 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.

More recently, some positive effects in more liberalized sectors, free of harsh content requirements are identifiable; single-brand retail has flourished. Attempting to ride the “consumption boom” tide, policy initiatives have seriously facilitated inflows into the sector. 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. In fact, India ranked first out of 30 emerging economies in A. T. Kearny's Annual Global Retail Development Index 2017 and 2018, only sliding down to second place in 2019.

*Sources:* Available at [http://www.moneycontrol.com/news/real-estate/fdimulti-brand-retail-hopeabeyance\\_1020882.html](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; <https://www. Kearny.com/global-retail-development-index>; Lama (2019)



Box  
6.2

### Local content requirements in the Indonesian 4G smartphone industry

Taylor-Strauss and Chen (2020) analyzed the impact of the implementation of a local content performance requirement on 4G smartphones in Indonesia in 2015. In its original form in 2015, the local content requirement (LCR) obligated firms to set up manufacturing facilities and to conduct 20% research and development in Indonesia. Later iterations of the LCR in 2016, however, introduced different schemes in which, domestic and foreign firms could both meet the 4G smartphone LCR, each of which is summarized in table 6.2.



Table  
6.2

### Tracks to meet 4G smartphone LCRs

No.	Scheme	Description
1	Hardware	<ul style="list-style-type: none"> <li>Manufacturing of 70%, consisting of 95% material, 2% labour, 3% production machinery.</li> <li>20% R&amp;D consisting of 10% licence, 40% firmware, 20% industrial design, 30% integrated circuit layout design.</li> <li>Apps of 10%, with minimum of two embedded local apps or four embedded local games that are actively being used by 250,000 users; the software injection process is done in the country, use of domestic server, and own local online app store.</li> </ul>
2	Software	<ul style="list-style-type: none"> <li>Manufacturing of 10%, consisting of 95% material, 2% labour, 3% production machinery.</li> <li>20% R&amp;D consisting of 10% licence, 40% firmware, 20% industrial design, 30% integrated circuit layout design.</li> <li>Apps of 70%, with a minimum of seven preload local apps or 14 preload local games that are actively being used by 1 million users, the software injection process is done in the country, use of domestic server, own local online app store, and the cost, insurance and freight (CIF) price of a minimum of 6 million IDR.</li> </ul>
3	Investment	<ul style="list-style-type: none"> <li>Investment of 400 billion IDR to 550 billion IDR is equal to 25% local content.</li> <li>Investment of 550 billion IDR to 700 billion IDR is equal to 30% local content.</li> <li>Investment of 700 billion IDR to 1 trillion IDR is equal to 35% local content.</li> <li>Investment over 1 trillion IDR is equal to 40% local content.</li> <li>This applies to investment only and the investment must be completed within three years. Vendors must realize 40% of investment during the first year and provide details on their annual investment.</li> </ul>

Source: Global Business Guide, 2017.

A big challenge preventing causal conclusions on the LCR's impact on inward FDI is the lack of reliable sector FDI data on 4G smartphones in Indonesia. However, through analysing greenfield investment data, Taylor-Strauss and Chen were able to illustrate that the immediate response of firms to the LCR was to increase their investments in the local market. The LCR most likely did not deter firms because of the market potential – the Indonesian smartphone market is one of only a few left in the world that has not fully matured. On the contrary, it is forecast to boom between 2015 and 2022.

Nonetheless, the increase in inward greenfield FDI was only temporary. Although inward FDI expanded in 2015 when the LCR was announced, since then it has dramatically declined. Firms with the largest market share are now already capable of meeting the LCR requirements and catering to the local market. The principal recommendation coming from this case study is that a performance evaluation of the LCR in its current form is urgently needed, as it only resulted in a one-time spike in inward FDI and has since then discouraged FDI. Such a performance evaluation should focus on determining if and how the LCR could be redesigned or removed in order to better achieve its stated aims, and support indigenous industry growth and value chain integration of indigenous firms in the smartphone sector.

Sources: Taylor-Strauss and Chen, 2020, Understanding the Relationship between NTMs and FDI: A Case Study Analysis, ARTNeT Working Paper Series (02)19.

A case can be made for mandatory performance requirements that stress sustainability. While appropriate national laws and regulations are still a superior way of ensuring sustainability, it could be acceptable in principle to demand that investors conform to internationally recognized principles and standards related to responsible business conduct and CSR, including: (a) OECD guidelines for MNEs; (b) United Nations guiding principles on business and human rights; (c) United Nations Global Compact; (d) ILO conventions on decent work, including Tripartite Declaration of principles concerning multinational enterprises and social policy (MNE Declaration); (e) environmental assessments and pollution control; (f) benefit sharing in natural resources; and abstention 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 example, 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).

## 2. Conclusion: Performance requirements

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 in achieving development goals and they are increasingly being replaced by trade policy instruments. Of course, countries that 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. 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. However, 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 does not? In today's competitive environment, insisting on performance requirements may result in losing the investment altogether. In addition, the performance of an 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 and "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 economical, 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: 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 and 2013). Many Governments use incentives to attract FDI and to promote domestic investment. There are multiple reasons why Governments provide incentives for



domestic or foreign investment. Some of the main incentives are (Loewendahl, 2009):

- To overcome a competitive weakness such as high costs of doing business or an 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.

More recently, incentives – especially in combination with SEZs – have often been applied to support Governments to diversify their economies (for example, in the Gulf Cooperation Council countries) or to enhance the competitiveness of countries (van den Berghe, 2021).

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 the case of a disproportionately 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.; such incentives comprise regulatory incentives that refer to “policies of attracting foreign-owned enterprises by means of offering them derogations from national or subnational 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) noted, “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, although 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.

More recently, Governments have started to distinguish between locational incentives (i.e., to steer or attract investment into favoured sectors or regions) and behavioural incentives (i.e., to influence the character, nature and quality of such investments). The difference between locational incentives and behavioural incentives thus reflects a difference in policy objectives. Locational incentives are aimed purely at attracting investors into the host country, while behavioural incentives are meant to entice investors to engage in certain sectors or business activities that result in higher benefits or increased levels of economic developments for a country – for example, productivity gains, economic diversification and skills development – and recently to attract sustainable FDI or FDI projects that contribute to countries reaching the 17 SDGs in 2030.

Recently, the OECD together with the G20 (OECD, 2020) started a work agenda on the tax challenges arising from the digitalization of the economy, and identified potential interactions between tax incentive policies and potentially harmful tax practices, such as MNEs’ opportunities to shift profits for tax purposes in the light of Base Erosion and Profit-Shifting (BEPS). The objective of this work agenda is to better understand how investment tax incentives are used across developing and least developed countries, and to what extent they contribute towards or may harm the implementation of national and international policy objectives, including with regard to the SDGs. Only limited information exists on how incentives differ across countries. The project will produce systematic evidence of the use and impacts of investment tax incentives, using a consistent methodology across countries. Improved monitoring of the composition and generosity of incentive regimes would allow for a better assessment of what types of incentives potentially enable positive

economic and social spillovers. This information is expected to advance international dialogue on tax incentives across various policy communities – particularly in the area of investment, tax and development cooperation policies. The work would help developing and least-developed countries to make informed decisions in relation to their corporate taxation policies (OECD, 2020).

Probably the most common typology of incentives is provided by the Investment Climate Advisory

Services of the World Bank Group (table 6.3) (Daniel and Forneris, 2010). Globally, including in Asia and the Pacific, fiscal incentives are by far the most common, while accelerated depreciation and allowances for training and R&D are also used (UNCTAD, 2000). However, in general, 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.



**Investment incentives typology**

Type	Examples
<b>Regulatory</b> (exemptions from specific rules and regulations)	<ul style="list-style-type: none"> <li>● Easing of environmental requirements.</li> <li>● Exemptions from certain labour requirements.</li> <li>● Exemptions from performance requirements.</li> <li>● Exemptions from land ownership criteria.</li> </ul>
<b>Financial</b>	<ul style="list-style-type: none"> <li>● Cash grants.</li> <li>● Subsidies: <ul style="list-style-type: none"> <li>– Infrastructure and land subsidies;</li> <li>– Job-training subsidies;</li> <li>– Cost-sharing subsidies</li> <li>– Interest subsidies.</li> </ul> </li> <li>● Relocation and expatriation support.</li> <li>● Administrative assistance.</li> <li>● Loan guarantees.</li> <li>● Equity participation.</li> <li>● Temporary wage subsidies such as: <ul style="list-style-type: none"> <li>– Credit to investors;</li> <li>– Real estate subsidies;</li> <li>– Direct and indirect cost participation (for example, marketing, development, operating, supply of goods and supply of services).</li> </ul> </li> </ul>
<b>Fiscal (tax)</b>	<ul style="list-style-type: none"> <li>● Reduced corporate taxation, particularly: <ul style="list-style-type: none"> <li>– Reduced rates of corporate income tax;</li> <li>– Tax holidays;</li> <li>– Special tax-privilege zones.</li> </ul> </li> <li>● Incentives for capital formation such as: <ul style="list-style-type: none"> <li>– Special investment allowances (for example, accelerated depreciation, enhanced deductions);</li> <li>– Investment tax credits;</li> <li>– Allowances on reinvested profits.</li> </ul> </li> <li>● Reduced impediments to cross-border operations such as: <ul style="list-style-type: none"> <li>– Exemption from withholding tax;</li> <li>– Exemption from trade taxes (for example, reduced import and export taxes and customs duties);</li> <li>– Exemption or lowered taxation of employees (for example, lower personal income tax, social security reductions for expatriate executives and employees).</li> </ul> </li> <li>● Other tax reductions (lower sales tax, VAT reductions, property tax).</li> </ul>

Source: Daniel and Forneris, 2010.



### The Philippines' upcoming incentive: Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act

The Philippines is poised to reduce taxes on local and foreign companies under the Corporate Recovery and Tax Incentives for Enterprises (CREATE) Act ratified by the House of Representatives in 2021. The ACT seeks to reduce corporate income tax rate from 30% to 20% for MSMEs, and 25% for large companies, the highest tax rate among countries in South-East Asia. However, the bill still needs to be approved by President Rodrigo Duterte after final Senate ratification.

Certainly, the passing of the bill will give a boost to market confidence by providing instant relief to businesses suffering from business setbacks due to the COVID-19 pandemic. With the lowering of the corporate income, the reform bill will firm up the tax and incentive reforms that will make the investment climate significantly more attractive than the current tax and incentive regime. Furthermore, CREATE will bring in a massive inflow of investments that will create more jobs, especially as the Government is focusing its efforts on keeping pace with its ASEAN neighbours in attracting FDIs. This would enable the Philippines to open the floodgates to investment, while removing investment uncertainty. The CREATE Act alone is expected to generate up to PHP12 trillion (around US\$246 billion) in combined domestic and foreign investment over the next decade. Of that amount, US\$90 billion will be FDI. This will also result in around 1.8 million jobs during the next 10 years. Combined with economic amendments to the Constitution to maximize impact, this could lead to the creation of some 8.4 million jobs.<sup>2</sup>

Source: Philstar. Available at <https://www.philstar.com/business/2021/02/03/2074794/duterte-wins-stimulus-incentive-battle-create-passage>

Incentives are one of the *raison d'être* of Free Zones (FZs) or SEZs. Without the incentives it is less appealing for companies to set up shop within an FZ, although it is important that many of the successful

FZs offer more than just an incentive package combined with a real estate solution to tenants. Examples of some of these new forms of incentives are provided in table 6.4.



Types of investment incentives

Type of incentive	
Direct incentive	<b>Investment incentives</b>
	Provision of financing options primarily aimed at offsetting capital expenditures required for start-up, upgrade and/or stabilization of operation(s)
	<b>Land and infrastructure Incentives</b>
	Reduced rates and/or direct provision of land, public utilities transportation granted for specific investments
	<b>Training and employment incentives</b>
	Subsidized training programmes and education subsidies to reduce investors' training costs to develop workforce skills
Indirect incentives	<b>R&amp;D incentives</b>
	Grants, credits and lending instruments to support investments in R&D and innovation
	<b>Regulatory and administrative incentives</b>
	Granting exceptions from rules and regulations in combination with streamlined and simplified administrative procedures through One-Stop Shop services (OOS)
Indirect incentives	<b>Technical investment</b>
	Investment facilitation services, information provision and aftercare to ensure a "soft landing" of the investment project or further expansion

Source: van den Berghe, 2021.

<sup>2</sup> See <https://www.pna.gov.ph/articles/1129502>

The most comprehensive source of global incentives can be found at [www.incentivesmonitor.com](http://www.incentivesmonitor.com). This website contains the only database, developed by WAVTEQ, that is tracking globally incentive packages

awarded to companies for specific projects and related incentives policies. Recent data on the extent of global incentives provided to (foreign) investors during 2020 are provided in table 6.5.



**Table 6.5** Global incentives provided to foreign investors in 2020

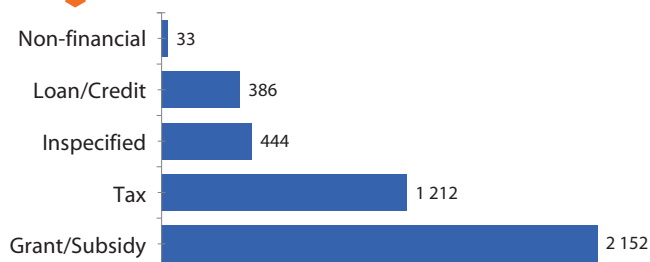
Deals	Incentives	Total Jobs	Capex (capital expenditures) <sup>3</sup>
4,051	US\$8.55 b Average: \$2.37 m	402.0 k Average: 109	US\$112.09 b Average: 47.80 m
New jobs	Safe jobs	Avg. income % capex	Avg. income/job
317.0 k Average: 116	84.9 k Average: 67	7.0 %	US\$26,679 *New + Safe jobs

Source: WAVTEQ – Incentives Flow from WAVTEQ 2021.

During 2020 more than 4,000 incentive awarded projects (largely domestic investments) were recorded globally with a total value of US\$8.55 billion, of which North America had a large share. This is also largely due to the transparency of information regarding awarded incentives across the United States. More than 400,000 jobs were impacted by these projects in one way or another: 75% (317,000) were newly created jobs and 25% (84,900) were safeguarded by the FDI projects involved. Most of the incentives were grants or subsidies (figure 6.1).



**Figure 6.1** Global incentives, by type, 2020



Source: WAVTEQ – Incentives Flow from WAVTEQ 2021.

## 1. Incentives: Do they work?

The effects of incentives, whether for inward or outward FDI (see chapter 3 for outward FDI incentives), are not uniform and depend on the type of incentive and the circumstances of the country

offering them. Table 6.6 shows some of the most common advantages and disadvantages of inward fiscal and financial incentives, which are then discussed below.

Collins (2015) observed that, on the one hand, investment incentives might 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 noted that incentives could address market failure and information asymmetries as well as help to direct investment in underserved markets. Incentives can also help to mitigate negative externalities, such as environmental damage.

In general, the costs of tax holidays outweigh the benefits. Apart from revenue loss, the following costs are associated with incentives (James, 2009 and 2013):<sup>4</sup>

- Distortion costs created by encouraging new investments that are detrimental to existing ones;
- Time and money spent by a business to lobby the Government for incentives;
- Time and money spent by a business to qualify for and receive incentives;
- Revenue lost due to illegal activity, such as from businesses that do not qualify for tax exemptions

<sup>3</sup> Capex includes all investment expenditures.

<sup>4</sup> Available at <http://www.imf.org/external/np/seminars/eng/2014/caribbean/pdf/S2p2-James.pdf>


**Advantages and disadvantages of fiscal and financial investment incentives**

Advantages	Disadvantages
<b>Lower corporate income tax rate on a selected basis</b>	
<ul style="list-style-type: none"> <li>• Simple to administer.</li> <li>• Revenue costs more transparent.</li> </ul>	<ul style="list-style-type: none"> <li>• Largest benefits go to high-return firms that are likely to have invested even without incentive.</li> <li>• Could lead to tax avoidance via transfer pricing (intra-country and international).</li> <li>• Acts as windfall to existing investments.</li> <li>• May not be tax spared by home country tax authorities.<sup>5</sup></li> </ul>
<b>Tax holidays</b>	
<ul style="list-style-type: none"> <li>• Simple to administer.</li> <li>• Allows taxpayers to avoid contact with tax administration (reducing chance for corruption).</li> </ul>	<ul style="list-style-type: none"> <li>• Similar to lower corporate income tax rates, except that it might be tax spared.</li> <li>• Attracts projects of short-term maturity.</li> <li>• Could lead to tax avoidance through the indefinite extension of holidays via “re-designation” of existing investments as new investments.</li> <li>• Creates competitive distortions between existing and new firms.</li> <li>• Costs are not transparent unless tax filing is required, in which case administrative benefits are foregone.</li> <li>• 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</li> </ul>
<b>Investment allowances and tax credits</b>	
<ul style="list-style-type: none"> <li>• Costs are relatively transparent.</li> <li>• Can be targeted at certain types of investment.</li> </ul>	<ul style="list-style-type: none"> <li>• Distorts the choice of capital assets towards projects of short-term maturity since an additional allowance is available each time an asset is replaced.</li> <li>• Qualified enterprises might attempt to abuse the system by selling and purchasing the same assets to claim multiple allowances.</li> <li>• Greater administrative burden.</li> <li>• Discriminates against investments with delayed returns if loss carry-forward provisions are inadequate.</li> </ul>
<b>Accelerated depreciation</b>	
<ul style="list-style-type: none"> <li>• Similar benefits to those of investment credits and allowances.</li> <li>• Generally, does not discriminate against long-lived assets.</li> <li>• Moves the corporate tax closer to a consumption-based tax, reducing the distortion against investment typically produced by the former.</li> </ul>	<ul style="list-style-type: none"> <li>• Some administrative burden.</li> <li>• Discrimination against investments with delayed returns if loss carry-forward provisions are inadequate.</li> </ul>
<b>Exemptions from indirect taxes (VAT, import tariffs etc.)</b>	
<ul style="list-style-type: none"> <li>• Allows taxpayers to avoid contact with tax administration (minimizing corruption).</li> </ul>	<ul style="list-style-type: none"> <li>• VAT exemptions may be of little benefit (under regular VAT, tax on inputs is already creditable; outputs may still get taxed at later stage.</li> <li>• Prone to abuse (easy to divert exempt purchases to unintended recipients).</li> </ul>
<b>Export Processing Zones</b>	
<ul style="list-style-type: none"> <li>• Allows taxpayers to avoid contact with tax administration (minimizing corruption).</li> </ul>	<ul style="list-style-type: none"> <li>• Distorts locational decisions.</li> <li>• Typically results in substantial leakage of untaxed goods into domestic market, eroding the tax base.</li> </ul>

Sources: Fletcher, 2002, as quoted in Rajan, 2004.

<sup>5</sup> 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 – see <http://definitions.uslegal.com/t/tax-sparing-credit>.

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):

- 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 example, 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).

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” (Daniel and Forneris, 2010).

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.<sup>6</sup>

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 example, Thomas, 2007, for an overview). James (2009 and 2013) and Investment Consulting Associates (2013) reported that the level of taxation on FDI mattered in developed countries with more or less similar investment climates, but that incentives mattered less in developing countries where incentives cannot compensate for an otherwise poor investment climate (see also, for example, Chaisse, 2016b; Kinda, 2014). James and Van Parys (2009) and Abbas and Klemm (2013) found that incentives matter in developing countries, but that the effect is relatively small. Loewendahl (2013) also found 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) found that export-oriented FDI is 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 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 and 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 6.4). 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

<sup>6</sup> 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, that is titled “Options for low-income countries” effective and efficient use of tax incentives for investment (IMF and others, 2015).

roughly equal alternatives, incentives can represent a decisive factor. In other words, incentives are often the ‘cherry on top’. 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 6.4

### 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 to 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 environmentally-friendly, save energy or use alternative energy to drive balanced and sustainable growth; (c) clusters to create investment concentration in accordance with regional potential and strengthen value chains; (d) investment in border provinces in southern Thailand to help to develop the local economy, which will support efforts to enhance security in the area; (e) special economic development 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); and (f) Thai overseas investment to enhance the competitiveness of Thai businesses and Thailand's role in the global economy.

The BOI provides a variety of incentives. This includes both tax incentives (e.g., exemption of corporate income tax, exemption of import duties) and non-tax incentives (e.g., permits) for businesses. However, depending on the nature of business activities, the requirements and procedure may be different. The BOI provides a list of project activities eligible for investment promotion that specifies seven categories of activities eligible for promotion: (1) agriculture and agricultural products; (2) minerals, ceramics and basic metals; (3) light industry; (4) metal products, machinery and transport equipment; (5) electronics and electrical appliances industry; (6) chemicals, paper and plastics; and (7) service and public utilities.

Moreover, each company must satisfy mandatory criteria for project approval. First, every activity must demonstrate that the value-added of its project will not be less than 20% of revenue (certain activities only require 10% of revenue). The project should also have a modern means of production, new machinery and high capital activities that must obtain international standard certification. Second, every project has to be environmentally-friendly. Third, a minimum capital needs to be invested and the feasibility of the project has to be assured. To that extent, the BOI new policy has abolished its previous location-based incentives (“zones”) and instead is granting activity- and merit-based incentives.

Activity-based incentives are granted to certain activities that boost Thailand's research and development capacities or certain key industries. The BOI classifies two groups of incentives, A and B, based on the importance of activities. Group A (subcategorized into A1 to A4) consists of activities using high technology. Group B (subcategorized into B1 and B2) consists of activities with less complex technology. Incentives largely depend on the particular business activity. The highest incentive given is for B2, B1, A4, A3, A2 and A1. These privileges can be used from three years up to eleven years if the company is granted an investment incentive privilege through the BOI process.

In order to attract and stimulate more investment or spending on activities that benefit the country or industry at large, merit-based incentives are additionally granted if the business is likely to: (a) enhance Thailand's competitiveness; (b) contribute to decentralization; and (c) develop industrial zones. Such merit-based incentives are available for all activities.

*Source:* Board of Investment, Thailand. See [https://www.boi.go.th/index.php?page=policies\\_for\\_investment\\_promotion](https://www.boi.go.th/index.php?page=policies_for_investment_promotion) and [https://www.boi.go.th/upload/content/newpolicy-announcement%20as%20of%2020\\_3\\_58\\_23499.pdf](https://www.boi.go.th/upload/content/newpolicy-announcement%20as%20of%2020_3_58_23499.pdf)

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) noted 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.<sup>7</sup> Malaysia is an example of a country that uses ITA together with other tax incentives (box 6.5).



### Box 6.5

#### Main tax incentives for manufacturing companies in Malaysia

As in virtually all countries, the incentive schemes for foreign (and domestic) investments are complex and consist of various mechanisms. For manufacturing companies in Malaysia, the major tax incentives for companies investing in the manufacturing sector are the Pioneer Status (PS) and the Investment Tax Allowance (ITA).

Companies in the manufacturing, agricultural, hotel and tourism sectors, or any other industrial or commercial sector, that participate in a promoted activity or produce a promoted product may be eligible for either PS or ITA. Eligibility for PS and ITA is based on certain priorities, including the level of value-added, the 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 that is 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, accelerated capital allowance, incentive for industrial building system (IBS), group relief and automation capital allowance. Specific incentive schemes apply to selected sectors such as agriculture, biotechnology, environmental management, research and development, training, approved service projects (ASPs), shipping and transportation or ICT.

Applications for various incentive schemes should be submitted to the Malaysian Investment Development Authority (MIDA) by a company before commencing operation/production.

A comprehensive overview of available incentives is provided by MIDA (2020) at <https://www.mida.gov.my/publications/malaysia-investment-in-the-manufacturing-sector/>

*Source:* MIDA, 2020, PricewaterhouseCoopers. Available at <https://taxsummaries.pwc.com/malaysia/corporate/tax-credits-and-incentives>

<sup>7</sup> 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. This is different from investment credit which allows businesses to deduct investment costs directly from their tax liability.



The decision to grant the extension of incentives requires 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 6.6).



### 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<sup>8</sup> 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 and 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<sup>9</sup> 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.

Sources: ICA (2013); James (2009 and 2013)

<sup>8</sup> It could be argued as to 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.

<sup>9</sup> Anchor investment refers to original/first investment that triggers confidence in other investors to follow suit.

## 2. Monitoring and evaluation of incentive policies

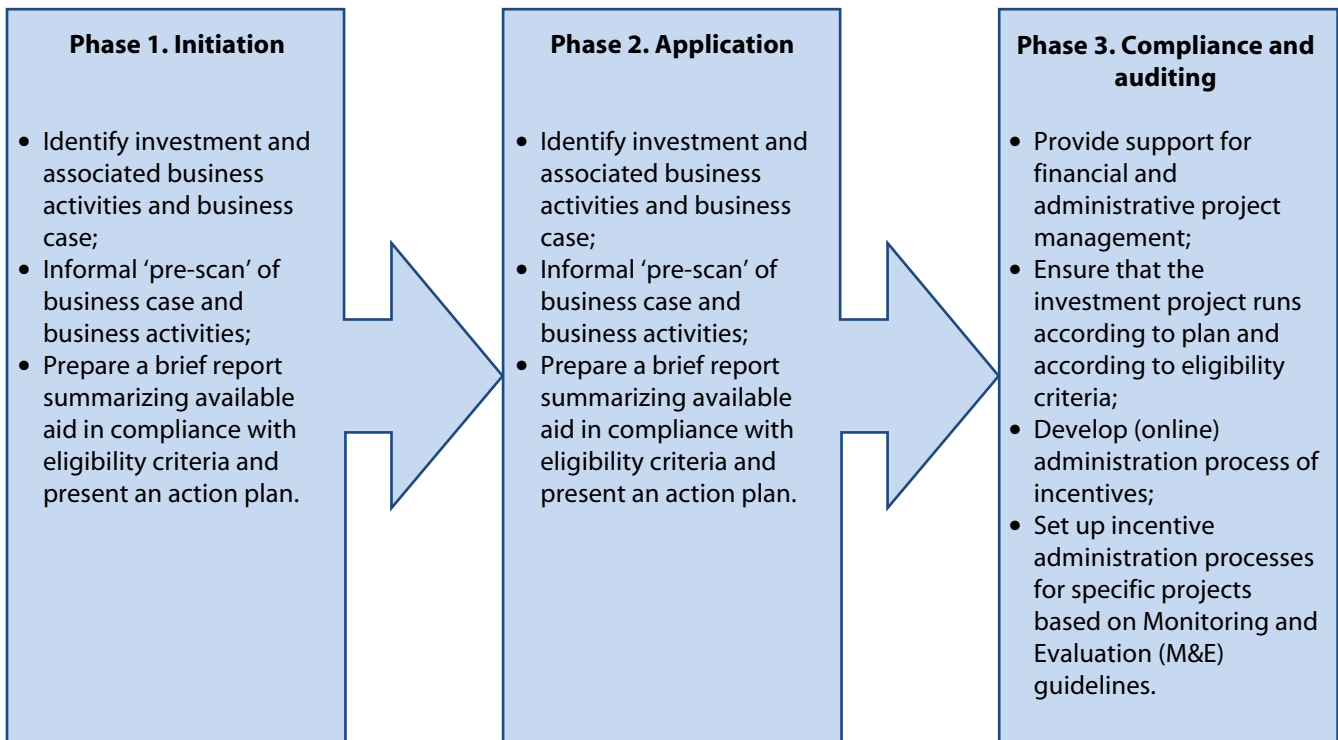
The best way to find out whether incentives actually have their desired effect requires a careful monitoring and evaluation (M&E) exercise which is part of the incentive administration system (figure 6.2).

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: Policymakers 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.



Stages of incentive administration



Source: Investment Consulting Associates, 2013.

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 as well as 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 government 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 6.7 shows an illustrative list of key questions used in Ireland to assess investment projects before recommending financial incentives.



### 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 also useful benchmarks for assessing foreign invested companies:

- (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 at <https://enterprise-ireland.com/en>

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 evaluate the actual 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, in compliance with the initial eligibility criteria and contributes to a country's economic development goals. With modern day IT

infrastructure, it is relatively easy to develop an online version that enhances uniformity and transparency. 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 in order 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 is related 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. 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 that are foregone;<sup>10</sup>
- Indirect cost of administration the incentives (for Governments) and application for incentives (for investors);
- Indirect cost of time and money spent by businesses lobbying for incentives.

Achieving 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 is related to the identification of metrics to calculate all involved direct and indirect costs and benefits as well as associated data collection (for more details see, for example, Johnson and others, 2013; and Chen, 2015).<sup>11</sup>

### 3. Recommendations for good incentive policies

Generally, when applied appropriately, incentives can: create partnerships that 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 does not already want to exist; or ensure a long-term connection between business and community.

In particular, the following points and recommendations should be considered in formulating an incentive programme, essentially echoing the importance of transparency, clear targets, continuous evaluation and precision. Before getting into the fundamentals, intention and investor behaviour should be clarified for optimal tailoring and outcomes:

- It is important to understand whether incentives should emphasize comparative advantages of countries or compensate for the lack of these comparative advantages (see chapter 5 for a discussion on competitive advantages). If it is the second point of action, they will probably fail. A reminder that compensating for a lack of

<sup>10</sup> A proper way to calculate tax revenue foregone is a tax expenditure review, which quantifies the revenue forgone for each provision, including for investment tax incentives. See IMF, and others, 2015, for more details.

<sup>11</sup> See also <https://www.smartincentives.org/blogs/blog/144025031-how-to-collect-data-to-determine-if-incentives-are-working>

comparative advantages is distinct from defying the comparative advantage for upgrading strategies that are accompanied by a range of supportive policies (Lin, Chang, 2009);

- 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;
- Aligning incentives with the needs of investors applies both to the investment motive as well as to the life cycle of the company investing. Resource-seeking investments are less prone to incentives as their investment location is mostly determined by the availability of a particular natural resource. On the other hand, incentives are highly appreciated by companies undertaking market-seeking and efficiency-seeking investment, as their choice of potential investment locations is wider. Incentives may therefore tip the final location decision in favour of one location.

All incentives should, in their outlook, consider international obligations and, ideally, harmonization and non-discrimination contributing to predictability:

- 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, and in particular the Agreement on Subsidies and Countervailing Measures and the TRIMS Agreement;
- As more and more countries employ a variety of innovative incentives for specific purposes, 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 and 2013);
- Ideally, incentives should not discriminate by nationality and should apply equally to domestic and foreign investors in any given sector in order to avoid distortion of the business environment.

Core to the implementation of incentives is the development of capacity-strong IPAs, while keeping bureaucracy and procedures simple. Therefore, it is essential to focus on enhancing the capacity of IPAs as it allows for effective monitoring and evaluation of incentives. A single entity also ensures coherence and cost-effectiveness when integrating new

incentives into existing regimes. Furthermore, the application and administration processes should be as simple and as concise as possible, avoiding bureaucratic overload while maintaining sufficient rigour in the process. Investment incentives should be affordable and lead to benefits exceeding costs (OECD, 2003). Creating awareness of, and providing timely and accurate information on sustainable investment incentives is also crucial for their uptake, as is the capacity of relevant monitoring/administrative/regulatory agencies.

Tax incentives should be part of the tax code for transparency and extended according to clear criteria. Two observations below are the preference of cost-lowering incentives over profit-based incentives and tax holidays:

- Tax incentives that lower the cost of investment, such as cash grants or credits, investment allowances, deductibles or accelerated depreciation, are often preferred over profit-based tax incentives (IMF and others, 2015; James, 2009 and 2013). Especially with regard to "Greenfield" investment, investors are more appreciative of incentives that directly offset these vast capital expenditures that should finance constructing the new facility, purchasing equipment and tools and paying salaries of the first employees;
- Sub-optimal are tax holidays, as they may lead to transfer pricing or transfer of 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 frequently ineffective for start-ups as often no income is generated in the start-up period when the tax holiday is applied anyway.

Fiscal Incentives should equally be target-based, transparent (box 6.8), and, in this, precise:

- Fiscal incentives may be valuable for the expansion of existing investments that are up and running and making a profit. Supporting skills development through the deduction of training expenditures or R&D via the deduction of research expenditures are examples of the use of such incentives;
- A fixed duration, for example, allows a regular analysis of the cost of the fiscal incentive relative to the benefits arising from (a) the investment (such as employment, exports and skill/capacity enhancement) and (b) its relation to 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.) vis-à-vis clearly stated targets.

Incentives for sustainable investment should be no different, embeddedness, transparency and targets are determining factors:

- Sustainable investment incentives should be 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;
- Regarding said outcomes, incentives should be based on well-defined targets. These should be research-based and should 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;
- Countries can consider utilizing the category of recognized sustainable investors (see box 6.10) to encourage investors to make their investment sustainable. Only investors classified under this category would be eligible for incentives. Continuous monitoring of the investments,

however, is also important to ensure that investors continue to adhere to the criteria set out in the category to receive the incentives.

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 presents operational criteria against which the relevance, quality and coherence of a policy framework can be assessed. The criteria fall into six broad categories: (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 into 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 6.8. For a full list of questions and supplementary questions, see <http://www.oecd.org/daf/inv/investment-policy/Policy-Framework-for-Investment-2015-CMIN2015-5.pdf> (pages 61-63).



#### 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 for 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 cooperation to counter abusive tax planning strategies?

Source: OECD Policy Framework for Investment, 2015.



### Incentivizing sustainable FDI: The recognized sustainable investor category

Promoting and attracting sustainable FDI is quickly gaining traction in many countries. Countries want FDI that aligns with their development priorities and contributes to development in the economic, social, environmental and governance spheres. Incentives can play an important role in increasing the levels of sustainable FDI, particularly through the creation of a special category of investor – ‘Recognized Sustainable Investor’ (RSI) (Sauvant and Gabaor, 2022). Governments can use this category as a reputational and financial incentive to influence investors to abide by corporate social responsibility and responsible business conduct guidelines, and ensure sustainable development in the country. Setting up an RSI category consists of the following three steps:

1. Establishing basic criteria that all investors must meet to qualify as an RSI. This includes investors committing to follow widely-recognized and accepted guidelines such as the United Nations Guiding Principles on Business and Human Rights, the International Labour Organization’s MNE Declaration, among others. It can also include additional criteria such as companies making their CSR statements and progress reports public, maintaining a comprehensive record of compliance with local laws and regulations, having been recognized in the past for their environmental, social, and governance performance, or maintaining appropriate due diligence and supply-chain risk management system.
2. Establishing country-specific FDI sustainability characteristics that investors would commit to meeting. In order for the host country to ensure that the investment contributes the maximum amount possible to the country’s sustainable development goals, countries can provide their own list of sustainability characteristics. This could include an investment project creating a certain number of jobs, creating backward linkages, ensuring environmental impact assessments, including gender consideration, or ensuring transparency and comprehensive stakeholder consultations. Host countries could also use existing sustainable FDI indicators to establish these characteristics, including the ESCAP sustainable FDI indicators.
3. Granting special benefits to RSIs beyond those generally available to all foreign investors. Special benefits, such as incentives, are needed to encourage an investor to commit to the potential costs associated with complying with the above mentioned criteria. The special benefits could include priority assistance to qualifying investors, expedited entry into the host country, offering targeted fiscal, financial, or other incentives, or helping to establish local linkages. In addition, the RSI label would also provide investors with valuable recognition and reputational benefits.

Source: Sauvant and Gabor, 2022, *Incentivising sustainable FDI: The recognised sustainable investor*, FDI Intelligence. Available at <https://www.fdiintelligence.com/article/80473>

## C. Special economic zones

Special economic zones (SEZs) take many different forms, but they 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 for SEZs 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 special (more liberal) regulatory frameworks with a specialized and

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 among others. There are many variations on the theme.

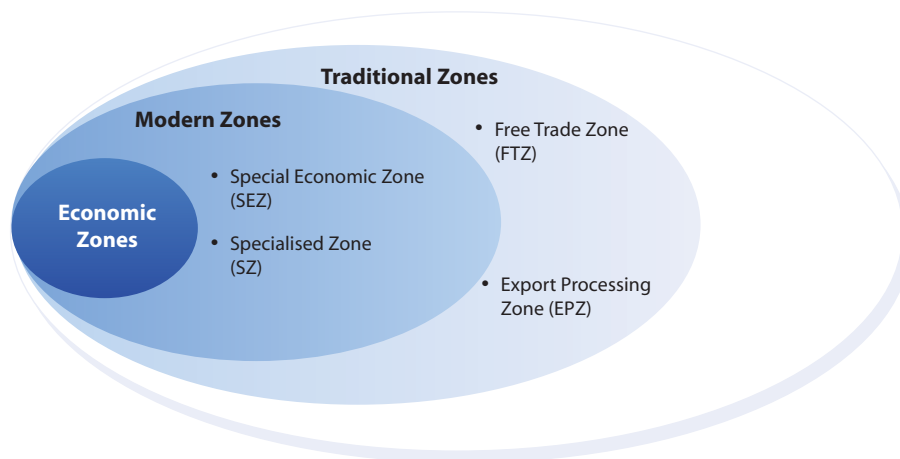
Free trade zones are a specific type of restricted access (e.g., fenced-in) industrial park housing concentrations of production facilities and related infrastructure. They are typically located at or near sea, air or land ports. have become a substantial part of the structure underpinning the global supply chain. UNIDO (2015) refers to the more generic term “economic zones”, comprising industrial parks, special economic zones, eco-industrial parks, technology parks and innovation districts. Chen

(2009) used the term “free economic zone” and pointed 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 the Subic Bay Freeport Zone in the Philippines, the Aqaba Special Economic Zone Authority in Jordan, and Sri City Multi-product

SEZ and Mundra SEZ in India.<sup>12</sup> More recently, the term “Economic Zone” (EZ) has been applied to emphasise the broader policy objectives of Governments implementing EZ policies for enhancing the competitiveness of countries or the role EZs can play in diversifying an economy. Figure 6.3 provides an overview of the different concepts which have been used.



**Categories of Zones**



Source: van den Berghe, 2020.

There are currently three active non-profit global or regional organizations that represent the interests of Economic Zones (EZs) globally or across the region, and which provide networking, knowledge and member-related services to free zones:

1. The World Free Zone Organization (World FZO) at [www.worldfzo.org](http://www.worldfzo.org). The World FZO is a global not-for-profit organization that provides one authoritative, collective voice representing the interests of free zones around the world. The World FZO was launched in Dubai, UAE, in May 2014, by its 14 founding members and under the auspices of His Highness Sheikh Mohammed bin Rashid Al Maktoum, Vice-President and Prime Minister of the UAE, and Ruler of Dubai. Registered in Geneva and headquartered in Dubai, the World FZO is the only truly international, multi-lateral organization for zones in the world today;
2. The Africa Economic Zones Organization (AEZO) at [www.africaeconomiczones.com](http://www.africaeconomiczones.com). AEZO is a

continental association consisting of leading public and private institutions in charge of the development, management and promotion of Economic Zones in Africa. Founded in November 2015 by Tanger Med, AEZO is striving to support African Economic Zones projects and to strengthen relationships within its ecosystem with devoted focus on growth and prosperity. It is guided by its strategic orientations to “foster collective knowledge sharing, provide strategic and technical assistance, connect with international business network and promote sustainable economic models and practices”;

3. The Free Trade Zones Organization of the Americas (AZFA) at [www.asociacionzonasfrancas.org](http://www.asociacionzonasfrancas.org), is a guild with 20 years of experience that defends and promotes the Free Trade Zones regime in Latin America. In 2011, AZFA acquired legal status and since then it has consolidated itself as the most important regional Association of Free Trade Zones.

<sup>12</sup> Mention of the information contained in this paragraph is made in various publications and online websites, e.g., <http://sezindia.com/sez-globally>



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), although in many cases SEZs are also open to domestic companies (suppliers) (Chaisse, 2020).

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 are they subject to tariffs, quotas and full customs procedures (Bolle and Williams, 2013). Box 6.10 provides some examples of how SEZs/FTZs work within the context of GVCs.



### 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 United States SEZ, taxes and tariffs are only payable if the shirt is eventually imported for consumption – that is, when it exits the SEZ into the customs territory of the United States. For example, it might enter an SEZ for the purpose of cost savings if, for example (a) more work is required (e.g., laundry labels), (b) some of the shirts were damaged in shipment and will be discarded or (c) 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 petroleum and the refinery has applied for and received status as an SEZ subzone (i.e., a site approved for a specific company or use). The tariff structure on refined oil products varies, such that some (e.g., petroleum) 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 oil may stay in the zone or be transferred to a chemical manufacturing facility that is in a nearby subzone for further refining. In the refinery process, as in other production processes in SEZs, tariffs are not payable on any waste products.”

Source: Bolle and Williams, 2013.

Bolle and Williams (2013) provided a useful description of FTAs and noted 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. 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 (box 6.11), SEZs have been established with various success rates in several countries, including Bangladesh, Brazil,

Cambodia, India, the Islamic Republic of Iran, Jordan, Kazakhstan, Pakistan, the Philippines, Poland, the Republic of Korea, the 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: (a) the EPZ or free zone, which focuses on manufacturing for export by Bangladesh (box 6.12); and (b) the large-scale SEZ, which usually combines residential and multi-use commercial and industrial activity (Farole and Akinici, 2011). The former represents a traditional model that 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 6.11 and 6.13 for the experiences of China and India with SEZs).



### SEZs in China: Historical perspective, characteristics and Shenzhen

Special economic zones were pioneered and introduced by China under Deng Xiaoping in the early 1980s. There are seven SEZs in China so far. The most famous and earliest SEZ, Shenzhen in 1980, has evolved from a small fishing village into a city of more than 10 million people within the time span of just 20 years. Encouraged by the SEZ's success, the Shenzhen SEZ was followed by the establishment of SEZs in Guangdong and Fujian Provinces (Zhuhai, 1980; Xiamen 1980); and Shantou, 1981) as well as the Hainan Island Province in 1988. Two new SEZs (Kashgar and Khorgas) were established in 2010 to encompass the Xinjiang autonomous region. In addition, a large number of open coastal cities, state-level new areas, FTZs, national economic and technological development zones (ETDZs), and high-tech industrial development zones (HIDZs) have been established in large and medium-sized cities.

In China, SEZ programmes have, on average, contributed 22% of China's GDP, 45% of total national FDI and 60% of exports. SEZs are estimated to have created more than 30 million jobs, increased the income of participating farmers by 30%, and accelerated industrialization, agricultural modernization, and urbanization (World Bank, 2015). During the 1980s-1990s more than 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 FDI projects up to a certain limit, building and improving the infrastructure, and regulating 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 (FIAS 2008).

Economic characteristics are represented as "four 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; and (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 example, Shenzhen was exempted from the requirement of submitting tax revenues to the central and provincial governments during 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 US\$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, and in 2019 leasing and business services attracted around US\$6 billion-worth of FDI. Shenzhen started with a focus on textiles and garments, and evolved as the leading city in China for high 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. Shenzhen registered more patents than any other city in China, with 261,502 patent applications reached as of 2019. Between 1978 and 2014, Shenzhen's GDP per capita grew by an amazing 33,581% from RMB606 to RMB203,500 (around US\$28,500). The population, in turn, grew from a mere 30,000 to a world city of more than 12 million inhabitants. China's 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). Moreover, to celebrate the 40th anniversary of the establishment of Shenzhen SEZ, China unveiled a new comprehensive reform plan for 2020-2025 to be implemented in Shenzhen. The Reform Plan is aimed at increasing market access for foreign investors, introducing legal and finance reform measures, and implementing specific business-friendly policies.

In conclusion, the economic impact of the Shenzhen SEZ has been overwhelmingly positive, prompting the Government to introduce market forces country-wide. Wang (2013) and Tantri (2011) found that the SEZs had contributed to inflows of FDI, an impressive growth rate of GDP, increases in total factor productivity, technology transfer, more employment opportunities and higher wages for workers in SEZs. They also found that SEZs neither crowd-out nor crowd-in domestic investment. However, Gopalakrishnan (2007) found negative impacts of SEZs and argued that only the Shenzhen SEZ could be considered a success, which could overshadow the other SEZs.<sup>13</sup> Among the negative aspects, he mentioned speculative markets in land-use rights and real estate, labour abuse and child labour, distress migration and crime. Other scholars mentioned that the success of SEZs has led to regional disparities, especially between eastern coastal areas of China and the central western regions (Tantri, 2011; Crane and others, 2018).

Sources: Wang, 2013, and online resources and references mentioned in the text.

<sup>13</sup> See <https://asia.nikkei.com/Economy/Shenzhen-s-success-overshadows-China-s-other-special-economic-zones>



### EPZs in Bangladesh

In 1980, Bangladesh was among the first countries in Asia and the Pacific to embrace the EPZ concept. On one side, the promulgation of the 1980 BEPZA Act led to the establishment of the Bangladesh Export Processing Zones Authority (BEPZA), the government agency responsible for the creation, operation and development of EPZs in the country. On the other side, the Foreign Private Investment Act of 1980 secured all FDI against expropriation and nationalization, and ensured fair and equitable treatment and free repatriation of profits. 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. Observing the startling success of those EPZs, a ninth zone is scheduled to open in the near-future.<sup>14</sup> Manufacturing industries were the original target, but the BEPZA is also currently targeting investment in utilities.

The EPZs are open to foreign investors, joint ventures and Bangladesh-owned companies. Around 57% of enterprises operating in the EPZs are foreign-owned. Leading investor countries are China, Japan and the Republic of Korea. China is the top foreign investor in the country's economic zones, of whatever shape, as the number of its formal proposals outstrips 13 other nations. Between fiscal year 2018 and December 2020, China grabbed more than one-third of the proposals made in the zones, according to BEPZA data. Economists said United States-China trade conflicts are forcing Chinese manufacturers to relocate their production facilities to alternative locations and Bangladeshi zones will be able to attract those investors. In FY 2019, China was the largest source of FDI in Bangladesh. Although BEPZA is encouraging environment-friendly investment, most of the Chinese investors are showing interest in investing in the chemical sector and coal-fired power generation.

BEPZA provides infrastructure facilities for investors, including fully-serviced plots with utilities under a 30-year lease as well as Standard Factory Buildings (SFB) for a two-year lease. It acts as a one-stop service authority for project approvals, work permits, import and export permits (issued within the same day of application), customs clearance at the factory site and aftercare services. The Government also enacted a One-stop Service Act in 2018 for providing a one-stop service to investors. 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 often include a five-year tax holiday, with a 100% tax exemption in the first two years, 50% tax exemption in the third and fourth year of operation and 25% tax exemption in the fifth year. Other incentives are enjoyed by investors such as duty-free imports of raw materials, machinery, equipment and construction materials as well as avoidance of double taxation, exemption from dividend tax or even full repatriation of profit, capital and establishment. Some EPZs have a seven-year tax holiday.

According to BEPZA's 2018-2019 Annual Report, the eight EPZs have contributed to an accumulated investment of US\$5 billion, attracted 473 industries generating direct employment opportunities for around 520,000 persons, and generating total national exports worth US\$7.5 billion, which is 18.6% of total exports. In addition, 66% of workers are women.

BEPZA is government-owned and operated. In order to enhance sustainability, the Government raised the minimum wage to US\$70 per month in 2013. In 2018, BEPZA re-fixed the minimum wage structure and other benefits for workers, based on their grades/posts and categories of EPZ enterprises.<sup>15</sup> It also passed the 2010 EPZ Workers Association and Industrial Relations Act and the Bangladesh EPZ Labour Act in 2019 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, green business initiatives have been imparted through introduction of environmental laboratories. For example, BEPZA set up hi-tech eco-friendly service-oriented industries including power plants, central effluent treatment plants (CETP) and water treatment plants (WTP).

*Source:* BEPZA (see <https://www.bepza.gov.bd/>, [https://bepza.gov.bd/files/reports/file\\_1602757154.pdf](https://bepza.gov.bd/files/reports/file_1602757154.pdf), [https://www.bepza.gov.bd/files/reports/file\\_1566118869.pdf](https://www.bepza.gov.bd/files/reports/file_1566118869.pdf)) and [https://thefinancialexpress.com.bd/economy/china-top-investor-in-bangladeshs-economic-zones1610506680?utm\\_source=newsletter&utm\\_medium=email&utm\\_campaign=world\\_fzo\\_weeklynews\\_dec\\_19&utm\\_term=2021-01-19](https://thefinancialexpress.com.bd/economy/china-top-investor-in-bangladeshs-economic-zones1610506680?utm_source=newsletter&utm_medium=email&utm_campaign=world_fzo_weeklynews_dec_19&utm_term=2021-01-19)

<sup>14</sup> See <https://bepza.gov.bd/Pages/epzdetails/mirsharai> and <https://tbsnews.net/bangladesh/infrastructure/bepza-doubling-plots-mirsarai-economic-zone-128449>

<sup>15</sup> See <https://bepza.gov.bd/app/webroot/ckfinder/userfiles/files/Wage%20Circular%202018.pdf>

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).<sup>16</sup>

According to FIAS (2008), 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, roads, etc.) as an incentive for private funding of on-site infrastructure and facilities;
- Assembly of land parcels with secure title and development rights given by the Government for leasing 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.

## 1. 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 have usually found a negative impact, but have 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 to the impact of incentives in sectors operating outside the zones. In any case, in order to assess the impact, there is a need to define what constitutes zone benefits and costs. FIAS (2008), Farole and Akinci (2011) as well as (Farole, 2018), World Bank (2017) and Zeng (2018) distinguished 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 revenue.

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 MNEs 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 noted 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 the 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 clearly had a positive impact

<sup>16</sup> Available at <http://www.internationaldevelopmentgroup.com/practice-areas/public-private-partnerships-special-economic-zones>

on economic variables such as employment generation, exports and FDI, as demonstrated by the SEZs in China and Bangladesh. However, these benefits have to be assessed against the costs, including social and environmental costs.

The costs of SEZs clearly go beyond only economic costs, 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 6.13 for the case of India). SEZs often lead to negative impacts on the environment through unsustainable water use, air pollution and factory effluents. For example, UNIDO (2015) reported 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 do not have a centralized waste water treatment or sewage system. In addition, industrial zones consume much energy due to inefficient production methods. Most companies in industrial zones have not adopted strict environmental standards and they release toxic emissions such as dust, SO<sub>2</sub>, NO<sub>x</sub> (and greenhouse gases, ...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. In order to make SEZs contribute to sustainable development, these issues need to be addressed through a proper policy and regulatory package.



**Box  
6.13**

**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 the Noida, Madras, Cochin, Falta and Visakhapatnam zones. With a view to overcoming the shortcomings experienced on account of the multiplicity of controls and clearances, absence of world-class infrastructure and an unstable fiscal regime, and with an objective of attracting 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 drastic simplification of procedures and Single Window clearance on matters related to central as well as state governments.

The Act offers highly attractive fiscal incentives and facilities, including exemption from custom/excise duties, service tax, central sales taxes, state sales tax and securities transaction tax, both for the developers and the units. Income tax holidays for 15 years are provided for SEZ developers – i.e., 100% tax exemption for the first 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. Provisions have also been made for the establishment of free trade and warehousing zones or the setting up of offshore banking units and an International Financial Service Centre. A Single Window SEZ approval mechanism has been provided through a 19-member inter-ministerial SEZ Board of Approvals (BoA). The BoA has been constituted by the Central Government in exercising the powers conferred under the SEZ Act. All the decisions are taken in the Board of Approval by consensus.

Lal (2013) noted that the SEZs attracted labour-intensive industries that have created employment and contributed to the tremendous growth 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 noted that “stability in fiscal concessions is absolutely essentially to ensure the credibility of Government intentions.” Moreover, SEZs have undoubtedly attracted new inward-investments into the country. While Aggarwal (2007) noted that a majority of investments in SEZs had come from domestic sources, Chakraborty and others (2017) found that the formulation of SEZ policy induced more FDI inflows, as the quantum of FDI had increased faster in the post-reform period. As a result, the share of FDI in total investment increased from 12% in 1989 to 18% in 2000 and to about 25% towards the end of 2010.

However, generally speaking, studies evaluating the impact of SEZs in India are not overwhelmingly positive and often note that the SEZ policy in India has only led to modest results in terms of exports, employment and investments. An Indian SEZ is an enclave area that is deemed to be a territory outside the customs territory of India for its authorised operations. Researchers have noted that FDI inflow is only concentrated in a few Indian

**Box 6.13** (*continued*)

states where SEZs are prominent, thus showing regional disparities and divergence among the country's states. Moreover, Aggarwal (2007) noted that the full potential of SEZs had not been reached. As of today, the current capacity utilization of SEZs across India is just over 50%. One of the reasons is that SEZs have attracted mostly medium tech activities that use similar technology as export-orientated firms outside the zones, thus showing little opportunity for technology transfer. Other widely negative economic impacts include revenue forgone from customs duties and the high costs of incentives compared to foreign exchange earnings and other financial benefits. The Reserve Bank of India says that large tax incentives can be justified only if SEZ units establish strong "backward and forward linkages with the domestic economy", which is a dubious proposition.

Concerning negative environmental and social impacts, Salil (2007) observed land grabbing, loss of income and lack of adequate compensation of displaced farmers. Human rights violations were also noted by Nomani and Rauf (2012). In addition, there are also cases where company management has colluded with local authorities in an effort to suppress the rights of the workers (Aggarwal, 2007). There have also been incidences of SEZs taking away of agricultural land from the farmers, leading not only to a decrease in agricultural activity but also deeper environmental degradation in the country. 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 by SEZs.<sup>17</sup> 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 socio-economic costs of human displacement and the social environmental impact of land acquisition may outweigh the benefits that have accrued from the policy.<sup>18</sup>

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 enclaved but sooner or later they will have to establish linkages with the rest of the country in order to have broader benefits. Moreover, 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, although the number of private sector-managed SEZs rose sharply after the adoption of the 2005 SEZ Act).

*Source:* References quoted in the text.

The empirical evidence of the actual impact is mixed and hampered by considerable statistical challenges. Farole and Akinci (2011) cited evidence of the successful contribution of SEZs to static economic benefits (in particular employment) in Bangladesh, China, the Republic of Korea, Taiwan Province of China and Viet Nam. However, they noted 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).

Although SEZs are rarely mentioned in WTO agreements, WTO members 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 that are

contingent on export performance), as clarified in a GATT Article XVI footnote. Similarly, performance requirements may run afoul with the WTO Agreement on Trade-Related Investment Measures (TRIMS). Generally, the nature of SEZs is crucial, as WTO disciplines apply to countries; privately-owned SEZs are not targetable (see Creskoff and Walkenhorst 2009). Overall, the single most important zone policy reform to achieve WTO compliance is to remove all requirements for 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.

Aggarwal and others (2011) noted 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 noted that "some of the sectors in Bangladesh, India

<sup>17</sup> Ibid.

<sup>18</sup> Available at [http://shodhganga.inflibnet.ac.in/bitstream/10603/21109/8/11\\_chapter%202.pdf](http://shodhganga.inflibnet.ac.in/bitstream/10603/21109/8/11_chapter%202.pdf)

and Sri Lanka, in which substantial exports from SEZs can be observed, were already outward-oriented before SEZs were set up.” They did 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 example, Viet Nam’s SEZ attracted 50% of all time FDI into the country until 2016 (Aggarwal, 2019). A study of 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 on certain areas, such as Penang (Furby, 2005). Others have found limited evidence of SEZ contribution to FDI attraction in Cambodia, for example, despite emphasising the strong potential (Tam, 2019).

A UNIDO study (2015) reported that there are more than 1,000 economic zones in ASEAN (most are industrial parks) including more than 80 SEZs. The study also noted 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 example, 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) 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 by Cambodia and Viet Nam to achieve middle income status through industrialization, although there are serious social and environmental concerns, as noted above.

Based on several decades of experience with SEZs, FIAS (2008), IFC (2013), Farole (2011 and 2018), World Bank (2017) and Zeng (2018) cited 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;
- A lack of financing opportunities;
- Poor zone development practices – inappropriately designed or over-designed facilities, inadequate maintenance and promotion practices;
- Subsidized rent and other services;
- Cumbersome regulations and procedures and restrictive controls on zone activity;
- Weak strategic planning, including inadequate or corrupt administrative structures or too many bodies involved in zone administration; a lack of coordination between private developers and governments in infrastructure provision;
- Mismatching comparative advantages;
- A lack of sector focus;
- Poor investment promotion activities and a lack of coordination with national IPAs, hindering a conducive investment environment;
- Exclusion of merchandise processed in zones from entry under bilateral and regional trade agreements.

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? 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 responsive to market requirements, which often require a feasibility study.

## 2. SEZs, Industry 4.0 and the digital economy

The rapid rise of Industry 4.0 (IR 4.0) (see chapter 4) has changed the competitiveness of countries for attracting FDI in specific industries and this will also have an impact on the future of SEZs. Based on van den Berghe and Moujaes (2020) the following trends emphasize how IR 4.0 will have an impact on SEZs and their ability to attract FDI.

1. A determinant of success and survival for companies in IR 4.0 is innovation. Thus, companies are looking for locations where an innovative-friendly environment is set up. This has an impact on the type of talent companies look for. Trends show that the necessity of cheap labour is becoming less important, as highly-skilled talent is more in demand. In addition, IR 4.0 makes clusters such as free zones more attractive locations for companies. This is due to

the vast knowledge base in close geographical proximity, the existence of an agglomeration of companies and talent, and finally, the potential to provide a more stable, less uncertain environment of trust and cooperation.

**Conclusion:** Companies will locate in zones that are closely located to regions where highly-skilled talent lives or would want to live. Proximity to local academic institutions, partner companies or zones that have partner programmes with knowledge-based institutions (e.g., for training) tend to be more favourable for potential investors in an IR 4.0 world.

2. In a high-risk world and an era of continuous disruptions, business-friendly regulations and environments can go a long way to managing the risks of innovation. This has an impact on the way companies view incentives. Financial incentives and tax-benefits will still be an important aspect of business decisions, but companies will begin to prioritize locations where R&D spending and investments to keep up with IR 4.0 trends are supported.

**Conclusion:** Companies will locate in zones where tax-cuts on R&D spending and credit support for training and talent development are offered.

3. Corporate expansion is already different in IR 4.0. Business frameworks, even within manufacturing companies, are shifting from “product to service mindset”. This results in a “Product Service System” concept, where product-service bundles are offered as solutions for customers. The concept relies on suppliers, customers and other partners becoming part of a networked and interrelated ecosystem. As a result, companies are less inclined to undertake a greenfield investment purely based on costs, while the integration in the local value chain is minimal.

**Conclusion:** Companies will locate in zones where the ability to build strategic partnerships, collaboration agreements for technology developments and supportive networks is available.

4. Industry 4.0 will change the way people work. The common fear is that machines will be used to replace workers, but many economists project that in fact, machines can be used to better equip and support teams rather than replace them. It is nonetheless clear that Industry 4.0 presents opportunities to change the nature of work in organizations. The use of technology in the workplace will foster greater collaboration and create more innovative, insightful and creative roles for the future. It remains clear that one of the key advantages that humans will always have over machines is empathy and

creativity. Technological change makes this even more relevant and not less.

**Conclusion:** Companies will locate in SEZs that provide collaborative work spaces that are good for innovation and creativity and support the trend of how the nature of work and the requirements of the workplace are changing.

5. In fact, IR 4.0 will be the main determinant of which sectors remain relevant in the future. In 2018, the World Economic Forum projected strong employment growth in sectors such as AI, robotics and blockchain as well as non-tech positions such as customer service, training and skills development, sales and marketing. Certain industries will grow, others will become irrelevant and new ones will emerge. Companies within different industries evaluate different criteria while internationally expanding.

**Conclusion:** Companies will locate in SEZs that are supported by strong and stable digital infrastructure that is needed to support IR 4.0.

Services provided by SEZs must be adapted and uniquely tailored to the industries of the future. IR 4.0 is a development that creates both challenges and opportunities for free zones. Those zones that are able to adapt and make the changes necessary will be most successful and reap the benefits of IR 4.0.

Many advanced digital economies have created specialized enclaves (physical and virtual) to boost digital commerce and innovation. In many ways, these parallel the role played by SEZs in the traditional economy. By providing participating firms with superior infrastructure and trade support – and exempting them from many levies and procedures – SEZs have helped many countries to boost FDI, exports and innovation in manufacturing.

Currently, the digital economy’s specialized enclaves take the four broad forms detailed below, but will no doubt evolve as innovation progresses (Premila, 2020).

(a) *Digital technology parks and innovation districts*

The oldest form of specialized digital economy enclave is the digital technology park. These are a direct progression of the research and science parks/technology parks first set up more than 50 years ago. Firms locating in such parks are provided with specialized and superior equipment, infrastructure and laboratory facilities at a subsidized cost, to better enable them to undertake high-end research and innovation of national and commercial use. Asia already has a number of such parks, producing and exporting electronics hardware (e.g., China, Taiwan Province of China, Indonesia, Malaysia, Republic of



Korea, Thailand, Viet Nam), or developing and exporting software or Internet-based services (e.g., India and the Philippines).

Many of today's digital technology parks aim to become world leaders in specific digital technologies. Malaysia has, for example, set up South-East Asia's first drone and robotics centre at Johor to speed up local development and commercialization of these technologies, in a manner that would make it home to these world-leading technologies. Cyberjaya, just outside Kuala Lumpur – already home to more than 2,300 start-ups, SMEs and large tech businesses – is working to become a major hub for ICT and multimedia research and industry.<sup>19</sup> Target investors include MNEs wishing to harness multimedia technology to guide their global manufacturing and trading operations.

Today's most advanced digital technology parks typically spread across a wider area, containing residential, commercial, leisure and outdoors facilities, so that they might attract and retain the world's best talent. They are thus referred to as "innovation districts". In Asia, Cyberjaya and Singapore's Jurong Innovation District (JID) are pioneering examples. JID is "designed to be Singapore's largest living lab" for the development and prototyping of IR 4.0 technologies. Its facilities include: (a) research and prototyping laboratories for advanced manufacturing and digital technologies, including 5G and autonomous vehicles; (b) specialized office buildings for established firms and start-ups focusing on IR 4.0 and 'smart city' technologies; (c) advanced manufacturing factories; and (d) logistics facilities for the transportation of supplies and the export of manufactured goods.<sup>20</sup> Resulting innovations and prototypes – including enhanced 5G, autonomous vehicles and smart city technologies – can also be live-tested in the district. Many global companies have already located major IR 4.0 R&D operations in JID, including Hyundai, Siemens, Bosch, Flowserve and Shimano.

#### *(b) Technology and innovation sandboxes*

Closely related to digital economy parks are digital 'technology and innovation sandboxes,' government-sponsored innovation programmes designed to speed the development and commercialization of strategic digital technologies by local entrepreneurs. By underwriting such 'sandboxes,' host Governments seek to competitively select the best local technologies and become global hubs for these digital technologies.

Malaysia's National Technology and Innovation Sandbox (NTIS), for example, enables digital economy researchers, innovators, startups and high-tech entrepreneurs to test their products, services, business models and delivery mechanisms in a live environment. In addition, it relaxes selected processes and/or regulatory requirements to speed up commercialization.<sup>21</sup> Current priority areas are health care, manufacturing, agriculture, education, travel and tourism. NTIS is thus currently supporting the development of: (i) robots to help front-line hospital workers treat COVID-19 patients as well as the recovery of those affected by stroke and other illnesses; (ii) semi-ventilators to assist patients with breathing difficulties; (iii) agricultural robots to enhance agricultural worker efficiency; (iv) automated drones that spray pesticide precisely; and (v) manufacturing robots for pick-and-place functions.

Other examples are Hong Kong (China) and India, which have established digital innovation sandboxes for the development and piloting of digital finance and insurance solutions. (Finextra, 2020; disruptive.asia, 2020).

Currently, some sandboxes only permit the participation of local innovators, while others enable foreign firms to take part.

#### *(c) Cross-Border E-commerce Zones/Digital Free Trade Zones*

A completely novel type of enclave is the 'Cross-Border E-Commerce (CBEC) Zone', first piloted by China in 2015 at Hangzhou. The express purpose of such zones is to boost cross-border e-commerce by facilitating international e-commerce shipments to individual consumers. Local firms locating in such zones can directly ship online orders to individual customers overseas. In parallel, overseas e-commerce platforms fulfilling orders from overseas retail customers can ship products to CBEC zones in their country for onward delivery. In China, consumers currently place international orders through the relevant CBEC zone website, and the foreign e-commerce supplier immediately ships the product to this zone, generally by air (Dezan Shira and Associates, 2020). Once cleared by the zone's customs office, the product is delivered to the consumer.

Since, in both cases, e-commerce orders are imported or exported for personal use and cannot be resold, CBEC firms and MNEs are exempt from licensing approvals and value-added tax, and pay

<sup>19</sup> Cyberjaya, available at <https://www.cyberjayamalaysia.com.my/>

<sup>20</sup> Jurong Innovation District website, available at <https://estates.jtc.gov.sg/jid/about#overview>

<sup>21</sup> National Technology and Innovation Sandbox website, available at <https://sandbox.gov.my/en/home#Introduction>

reduced corporate income tax. CBEC exports are also exempt from retail consumption tax. However, retail importation is only permitted for products appearing on the Government's List of Goods under Cross-border E-commerce Retail Importation,<sup>22</sup> which range from infant formula, health food and medical devices to frozen aquatic products, alcohol and consumer goods. Consumers do not pay duties for single transactions worth up to RMB5,000 (US\$729). The maximum individual quota for annual importation is RMB26,000 (US\$3,791) (Dezan Shira and Associates, 2020).

China now has 105 pilot CBEC zones spread across the country, including more remote internal areas (Dezan Shira and Associates, 2020a). Participating firms can now fulfil all customs procedures within their respective zone, greatly speeding up shipments to foreign and Chinese customers, and facilitating returns. This also makes it significantly easier for SMEs, listed on e-commerce websites, to service individual customers overseas. In 2019 alone, China's CBECs dispatched more than 300 million parcels globally. Of that total, 29.29% went to the United States, followed by France (6.42%), the Russian Federation (6.10%), the United Kingdom (5.55%) and Germany (4.59%) (Dezan Shira and Associates, 2020a). CBEC exports account for more than 11.25% (in 2020) of total Chinese exports – up from 2.2% in 2015 – and are likely to increase strongly during this decade (Dezan Shira and Associates, 2020a).

An added benefit has been the mushrooming of new value chains, locally and internationally, since each zone contains a mix of e-commerce platforms and supply partners, manufacturing firms, transportation firms and financial services firms. China's CBEC firms have also jointly invested in 1,200 warehouses internationally, in/from which they agglomerate and dispatch orders (Dezan Shira and Associates, 2020a).

Other countries have now begun to replicate and adapt this model. Malaysia set up its first Digital Free Trade Zone (DFTZ) on the outskirts of Kuala Lumpur in early 2017. Its key objectives are to (i) facilitate international purchases of Malaysian goods through international e-commerce platforms, (ii) boost SME exports and (iii) grow Malaysia into an ASEAN hub from which global e-commerce firms can service regional consumers. Firms locating in the zone receive exemptions similar to those offered by China's CBECs as well as practical support in e-fulfilment, finance, insurance, logistics, customs and other clearances. The zone has also drawn investments from foreign e-commerce, real estate

development, finance and logistics firms, among others.

#### (d) *Virtual SEZs*

A fourth – still emerging – model is, for the purposes of this handbook, what could be called the 'virtual SEZs', in which host Governments create digital platforms and skills that enable local workers to sell digital services globally. They could do this in partnership with – or with investments from – foreign firms.

Malaysia's GLOW (Global Online Workforce) Penjana<sup>23</sup> programme offers a pioneering example of this idea. This programme helps qualified Malaysians become "competitive digital freelancers, winning international jobs and project contracts on freelance platforms and earning sustainable income." Launched in mid-2020, its digital platform and intensive training programme connects local workers with: (i) global assignments in the areas of website design, IT and software; (ii) writing and content; (iii) design, media, architecture; sales, marketing and social media; and (iv) data entry, administration and social assistantship. In tandem, the Government of Malaysia's Digital Talent Development Strategy continues to build the digital skillsets of local citizens, since workforce quality is the principal attraction for FDI in this sector.

Since 'virtual SEZ' workers deliver services digitally, they need not only work from specified geographic locations, as in the case of physical SEZs, but even from the comfort of their homes. However, their participation in a government-intermediated and government-supported programme is the digital equivalent of physically locating them in the geographically-delimited area of an SEZ. More importantly, as in physical SEZs, their 'export' of digital services creates foreign exchange earnings.

#### (e) *NxtZones*

NxtZones are a new free zone model for the future customized to a changing global economy and IR 4.0 (van den Berghe, 2021). The NxtZones model connects ideas, innovation and entrepreneurship in various high-value, high-growth sectors. NxtZones is a global network of integrated and connected Economic Zones that create jobs, attract FDI and promote economic development, with a clear mandate for sustainability, perfectly aligned to the 17 United Nations SDGs. NxtZones will (i) successfully transform existing zones into this new FDI 4.0 concept, and (ii) develop brand new zones with a

<sup>22</sup> For more details, please see the notification from the Ministry of Commerce, Government of China, available at <http://cws.mofcom.gov.cn/article/swcjzc/202001/20200102929369.shtml>

<sup>23</sup> For more information on the GLOW Penjana, see <https://erezeki.my/glow>

high-tech, global cooperation and funding approach, focused on new global macro trends and existing strengths or clear-cut strategies identified in different countries.

NxtZones are carbon neutral, autonomous vehicle enabled and based on circular economy principles. At the core of the NxtZone design is a conjunction of academia, research, entrepreneurs, venture capital and sustainable practices. This powerful equation brought about the Silicon Valley in California. NxtZones will be the new digital Global Silicon Hub. The first NxtZones in development focus in particular on digital and IR 4.0 technologies (van den Berghe, 2021, and [www.NxtZones.com](http://www.NxtZones.com)). The NxtZones concept is based on the changing context in which SEZs need to operate and re-create their sources of competitive advantage with an increased focus on soft incentives (like one-stop-shops) new facility services, sustainability in set up and operations, and better embeddedness of SEZs in the domestic economy.

The next subsection seeks to summarize the success factors for SEZs and policy recommendations for successful SEZ development, operation and management.

(a) *Success factors and policy recommendations for SEZ development, operation and management*

Based on best practices and 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; Farole, 2018; World Bank, 2017; and Zeng, 2018):

(i) Macro trends:

- 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 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.);

- 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);
- Services industry and FDI in services are becoming increasingly important. However, there is no explicit need to have SEZs to develop services (see the section on digital SEZs and IR 4.0);
- SEZs need to be aligned with changing competitiveness as a result of FTAs, in particular mega-regionals such as the ASEAN Economic Community, the Comprehensive and Progressive Trans-Pacific Partnership Agreement and the Regional Comprehensive Economic Partnership;
- SEZs should be more seen as a catalyst for FDI and economic development. SEZs can create a competitive advantage and should be seen as more than just a tool or instrument in attracting FDI. SEZs should be seen more as helpful elements to develop an economy. Aside from offering many incentives to foreign investors to attract FDIs, SEZs offer an opportunity to ensure development in certain sectors;
- With many FDI destined to SEZs (e.g., in the case of China) this may create competition among smaller and larger cities and regions. Government policies need to ensure that the benefits of the SEZs reach a much broader geographic region rather than just the immediate city or region in which the SEZ is located.

(ii) Infrastructure:

- SEZs should provide necessary infrastructure and common services. However, investment facilitation and cutting red tape is still needed for them to be successful. In addition, skilled labour supply is another prerequisite that does not automatically come with SEZs. SEZs can only be effective with a proper and competent management structure;
- 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;

- 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 wastewater disposal, wages and labour conditions, public utilities, time indications for development;
- A trend is the increasing specialization of facilities and services catering to the unique needs of target industries and which have been developed on an integrated rather than stand-alone basis. These integrated development projects allow developers to offset the relatively low profitability of industrial properties with higher margin commercial and residential facilities. In many “next generation” zones, particularly privately-run zones, services cater to higher value-added industries and are able to charge premium rates and move “up-market”.

(iii) Structure:

- 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 a focus on R&D, compliance with international standards and availability of certification agencies, and training of SEZ personnel;
  - 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 demand-led. The information contained in the feasibility study should be used in master planning and development phasing and should: (a) be based on “real-world” financial and economic-impact analyses; (b) ensure that public investments in infrastructure are economically efficient; and (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: (a) identify the main target sectors for investment in SEZs; (b) determine investors’ critical investment drivers and constraints; (c) estimate investor demand for serviced land (m<sup>2</sup>), pre-built facility space (m<sup>2</sup>), and utility services in two 20-year scenarios – base case, (likely scenario) and an aggressive case (best-case scenario).
- (iv) Legal:
- 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 will be willing to invest in the area even if the policy environment or location is less attractive (Yehoue, 2009);
  - SEZs need to comply with international standards and rules, i.e., prevailing FTAs and WTO (e.g., TRIMS, SCM Agreement) and ILO (on labour standards);
  - 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;
  - SEZs need independent regulatory bodies backed up by law. The regulatory authority may be different from the development agency.
- (v) Management:
- Zone authorities should have sufficient autonomy, particularly for staffing, budgets, spending and policymaking. An independent board should oversee the operations of the zone authority. The board should be comprised of key government ministers and private sector representatives, and should 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;
  - Zones should be managed on a cost-recovery basis and should be customer-focused. A cost-recovery basis is enhanced by limiting subsidies and charging fees that are based on market prices;
  - 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;
  - Proper coordination mechanisms should be established among government agencies involved in policymaking, investment, trade, zone

development, land development, labour, finance and customs etc. Proper coordination between national and local government is also necessary. Because private zones are run on a cost-recovery basis, they are generally more responsive to tenant needs, and therefore provide a wider range of property management services and amenities. As such, private zones are generally able to command higher rates as this reflects the preference for the market to locate in a better-configured and better-run private zone.

(vi) Sustainability:

- Environmental and social sustainability is essential for SEZs, but is 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.

(vii) Location:

- 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.

(viii) Incentives:

- 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. In addition, incentives should be performance-based (see section B).

## D. Discussion questions

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 type 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?

## CHAPTER



# Fostering linkages between FDI and the local economy

## A. Policy focus: Forging linkages

### 1. Defining linkages

The forging of linkages, in particular backward linkages, with local suppliers, typically SMEs, has traditionally been an important policy objective of FDI, as successful linkages are believed to lead to positive spill-overs.

Spillover effects include exchanges and learning opportunities between MNEs and domestic firms and SMEs, and typically involves the transfer of technology, skills, tacit knowledge and expertise. In addition, obtaining direct finance and collateralizing receivables from large, credit-worthy MNEs also may encourage domestic firms to partner with MNEs. These linkages altogether may upgrade and/or enhance the local economy's productivity, skills base, industrial capacity, market diversification, technological base, innovation and competitiveness; it is one of the most effective and fastest ways of upgrading the domestic private sector (UNCTAD, 2004) and encouraging SME formation, particularly in developing economies (Krylova, 2006).

Linkages between foreign MNEs and domestic SMEs are crucial to the success of a market economy. Local firms may simply observe and duplicate the behaviour of the foreign MNE (Blalock and Gertler, 2005). Labour movement between foreign MNEs and local SMEs (i.e., employees that leave the foreign MNE and join or establish a local SME) may generate spillover effects. The entry of foreign MNEs may encourage other international service providers (e.g., trade brokers, accounting firms and consulting firms) to become available to local SMEs. However, direct interaction between a foreign MNE and a domestic SME through cooperation and partnership may generate the strongest positive spillover effects.

Therefore, linkages function as “transmission channels” that facilitate and mediate spillover effects from MNEs to domestic firms, and transfer wider spillover effects of FDI into the local economy (Potter, 2005). In addition, linkages prevent foreign investors from leaving a country that it has invested in too soon, making them less “foot-loose.” (Altenburg, 2000; UNCTAD, 2001; Kneller and Pisu, 2007). The following types of linkages can be distinguished:

(a) *Vertical linkages*

These can be backward (sourcing inputs from local suppliers) or forward (using local enterprises as customers). These linkages can have spillover effects; such inter-industry “vertical” spillovers, in turn, can be further classified according to the buyer-supplier relationship between the domestic firm and the MNE:

- Linkages through competition (OECD, 2005), where the entry of MNEs into the local economy puts local firms under pressure to improve their efficiency, productivity, products, delivery and standards (it may also be considered a horizontal linkage in the case of intra-industry competition);
- Forward linkages with customers, where the MNE acts as the supplier of products, components, intermediates, material, goods and services to the domestic firm active in downstream industries (e.g., after-sales services) that generate availability and quality effects (Farole and Winkler, 2014);
- Backward linkages with suppliers or supply chain linkages, where the MNE acts as the buyer of products, components, intermediates, material, goods and services from the domestic firm that is active in upstream industries, which can be obtained from arm’s-length market transactions to deep and sustainable inter-firm supplier relationships (OECD, 2005). Vertical backward linkages are the most common between MNEs and SMEs in developing countries where the latter acts mainly as a supplier to the former.<sup>1</sup>
- Linkages with technology partners (Mugione and Farinelli, 2010), where the MNE cooperates with a local firm through joint ventures, licence agreements, partnerships or strategic alliances. The partnership offers mutual benefits (e.g.,

direct access to the local market for the MNE and access to techniques, skills and knowledge for local firms) and may result in collaboration effects.

(b) *Horizontal linkages*

Partnerships with local enterprises in competing industries for the joint manufacturing, marketing or development of products, services and linkages with technology partners. Through horizontal linkages the spillover effects that occur between the domestic firms and MNEs operating in the same industry are defined as “horizontal” linkages and thus consist of intra-industry engagements.

Some spillover effects may occur through both horizontal and vertical linkages:

- “Human capital effects” or “labour turnover effects” are effects that emerge as a result of skills or tacit knowledge embodied in the labour force that may move from MNEs to local firms due to workers’ mobility and the free movement of labour;
- “Demonstration effects”, that are generated as a result of local firms being exposed to technologies, skills and knowledge of MNEs (Farole and Winkler, 2014).

The development of linkages is not always evident, and spillover effects and externalities may not occur automatically or may even be negative. The latter is the case when, for example, the domestic industries are crowded out by the foreign MNEs, while MNEs with limited skills, requirements or economies of scale are an example of the former (Paul and Gallagher, 2007).

Vertical backward linkages have increased significantly with the rise of global value chains (GVCs) driven by efficiency-seeking FDI. Since the late 1980s, MNEs – both inside and outside the Asia-Pacific region – have invested aggressively in developing GVCs. They were 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

<sup>1</sup> More recently, the World Bank (2020) launched a publication on how policymakers can use investment incentives and other tools to promote backward linkages (in particular, technology transfer). One of the main policy conclusions of the report is that with the right policy instruments, a Government can strengthen backward linkages by combining public and private resources to remedy market failures. Low-income countries can focus on improving local suppliers’ capabilities through carefully designed supplier development programmes. This requires a concerted effort among different government institutions to promote backward linkages in an outward-looking and market-oriented approach (World Bank, 2020). The report also included a number of case studies, largely from the ASEAN region, that had achieved successful results in promoting backward linkages, largely thanks to effective targeting of the market failure and good administration of the programmes. However, the report also lists less successful examples largely due to with many challenges associated with the implementation of the programmes and the conditions that they are dependent upon.



communications technology. As some reports have noted (UNCTAD, 2001; Gilmore and others, 2018; Rungsithong and Meyer, 2020; Lorenzen and others, 2020), for MNEs 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 (even social and cultural proximity). Being near suppliers can make procurement more flexible, and easier to negotiate and monitor. However, on the one hand, MNEs sometimes do not have a choice but to source locally if they want to avail themselves of preferential market access under specific RTAs that contain rules of origin that mandate local content requirements. On the other hand, there are studies that have revealed very limited domestic involvement in various industries, such as the garment and apparel industry, due to burdensome rules of origin, while vertical linkages in the extractives industry are mostly absent (Moran, 2015).

Small and medium-sized enterprises' greater flexibility, adaptability to local economic conditions

and capacity to serve orders for smaller quantities have become key advantages that are linked to strengthened national competitive advantages as well as 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 in 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 7.1).



### Box 7.1

#### Forging horizontal linkages: Joint ventures

A joint venture is a legal organization that takes the form of a short-term partnership in which a joint transaction is undertaken for mutual profit. Generally, each entity 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.<sup>2</sup> 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.<sup>3</sup>

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, 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

<sup>2</sup> Available at [https://www.law.cornell.edu/wex/joint\\_venture](https://www.law.cornell.edu/wex/joint_venture)

<sup>3</sup> Available at <http://www.telegraph.co.uk/finance/newsbysector/transport/9684276/Jaguar-Land-Rover-seals-Chinese-joint-venture.html>

**Box 7.1** (continued)

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 example);
- Both partners are committed to providing 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 linking 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.

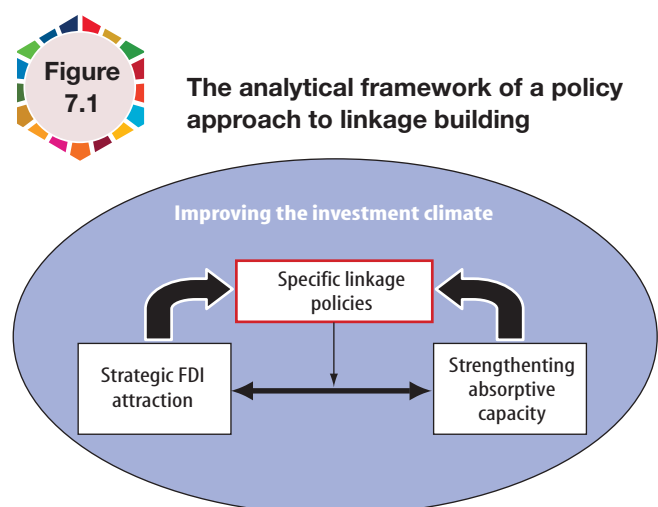
Established global MNEs may prefer wholly-owned subsidiaries or M&As to IJVs because the above success factors are often not in place. By acquiring or merging with a local partner, the foreign investor keeps control over its operations, but gains access to the local company’s knowledge of local cultures, regulations and market conditions. However, for smaller MNEs 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, an IJV often results in the take-over of one partner by the other (Stähler and others, 2007).

Source: References quoted in text

## 2. Forging effective linkages: research, evidence and policy options

Government interventions can contribute to creating a conducive business environment that fosters the creation of sustainable linkages by means of policies, incentives and regulations that anticipate the interests of both foreign MNEs as well as the domestic SMEs. This requires a clear and comprehensive “linkage building” policy approach, which not only supports the development of such linkages but also deepens them. Policies to attract FDI, improve the general investment climate and strengthen the absorptive capacity may complement this approach. The interplay between the different policies is shown in figure 7.1. This section follows the logical sequence of theory, conditions and obstacles, policy measures and review. Hence, it aims first to highlight the prospects of linkages as reflected in recent literature (box 7.2), second to

identify conditions conducive for successful policy interventions, and last to discuss some prominent policy measures.



Source: Mugione and Farinelli, 2010.



### Existing literature and the evolution of linkages to generate spillovers

Existing literature that addresses spillover effects of all types of linkages consists of case studies, which are hard to generalize, industry-level studies and research on firm-level panel data. This literature, above all, appears to acknowledge the fact that proximity of local firms to foreign MNEs has improved their productivity and standards (Krylova, 2006). However, empirical literature appears to be more concentrated on evaluating the spillover effects through horizontal linkages (Archanuan, 2009) and linkages due to competition effects (Paus and Gallagher, 2007), as opposed to the effects generated by means of vertical linkages.

Depending on the type of study and location (i.e., developing, transition or developed economy), empirical studies on linkages and subsequent productivity spillovers tend to find mixed results as to their success and reach. In fact, three subsequent generations of empirical literature have attempted to explain and evaluate the role of linkages in generating productivity spillover effects for host country economies (for discussion, see Fatima, 2014):

- (a) First generation – the “first generation” studies evaluated cross-sectional data at the industry level, which mostly pointed to the fact that horizontal linkages generate positive spillover effects. It should be noted this evidence may be questionable due to reverse causality and omission of firm-, time- and sector-specific variables (Havránek and Iršová, 2010);
- (b) Second generation – the “second generation” of empirical literature assessed panel data at firm-level, which found evidence that linkages between foreign MNEs and domestic firms did not generate any spillover benefits and, in fact, even resulted in negative spillover effects, particularly in developing countries;
- (c) Third generation – a meta-analysis of 57 empirical studies conducted between 2003 and 2013 evaluated the “third generation” of empirical literature on linkages and spillover effects (Havránek and Iršová, 2010). This generation underlined the significance of vertical (backward) linkages as an avenue for the transfer of technology and, eventually, positive spillover effects.

In short, for the host economy on the whole, vertical (backward) linkages may lead to increased value-added by the local private sector, productivity gains and improved competitiveness for the local economy as a result of increased demand for (highly specialized) inputs, and the introduction of more complex products and production techniques encouraging technological upgrading among local firms.

A fragile consensus seems to be emerging in the literature that vertical (backward) linkages between foreign MNEs and the domestic private sector are valuable to the domestic economy (Görg and others, 2009; Fatima, 2014; Mei, 2021). Overall, however, empirical support remains relatively scarce (Kiyota and others, 2005), outdated and often narrowly conceived, focusing only on specific countries, regions or projects (Li and Luo 2019). Especially in comparison with the academic attention paid to horizontal linkages this is an abysmal record. Among recent studies, a comprehensive international sampling of 32 countries shows strong support for backward linkages and mixed support for forward linkages, using a novel approach including sourcing and supplying differences of firms (Mei, 2021). A comprehensive regional sampling, including 2,198 firms in 75 industries from 2004-2011 in the West Midlands of England, found strong support for spillovers from forward linkages yet only weak support for its backward equivalents (Li and Luo, 2019). A country-level study of spillovers in China found that China’s WTO accession had an impact on

spillovers; forward spillovers only took place post-accession, while backward spillovers were found both pre- and post-accession (Kim and Xin, 2021). For a discussion and categorization of the limited studies that empirically evaluated the spillover potential through vertical linkages see Fatima (2014). Hence, these results strongly emphasize the role of individual country-level conditions and policies – an overview is presented below.

Many countries continue to face significant obstacles to forging effective linkages, most of them surrounding the absence of modern SMEs in developing countries (i.e., “Missing middle syndrome”). Common obstacles are the following (OECD, 2005; UNCTAD, 2006; UNCTAD, 2011):

- A lack of proper information on linkage and match-making opportunities (a role for investment promotion agencies);
- A lack of SMEs’ capacity to forge linkages with MNEs. Static and dynamic issues are prominent. Static issues include the inability of SMEs to

meet MNEs' requirements, in terms of price, quality, delivery, health, labour and skill as well as the environment, inter alia; Dynamic issues include weak managerial skills and a lack of entrepreneurial behaviour of existing domestic firms that altogether weaken the local economy's ability to benefit from linkage-related spillover effects (i.e., "absorptive capacity");

- Interrelatedly, yet importantly, limited access to finance, fund and credit is a major constraint for local SMEs in upgrading their processes, systems and technology base to comply with standards set by MNEs;
- A lack of MNE willingness to forge linkages, related to the host country's general attractiveness for FDI.

Local SMEs are often highly vulnerable to global economic slowdown (not least due to the issues raised above).

Proper government understanding of these obstacles is important in formulating the right policies that 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 example, 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 disproportionately 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 the provision of proper policy.

Before discussing the policy options, necessary and conducive conditions for policymaking need to be briefly considered. In many cases, MNEs operate their own assistance programmes to enhance the capacity of local suppliers or partners. Governments need to create the conditions under which such programmes will yield maximum results and encourage MNEs to implement such programmes. Governments also need to ensure that any form of linkage, including any programme implemented by MNEs themselves, conforms to sustainable and responsible business practices and contributes 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 MNEs 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. Spillovers are not automatic and

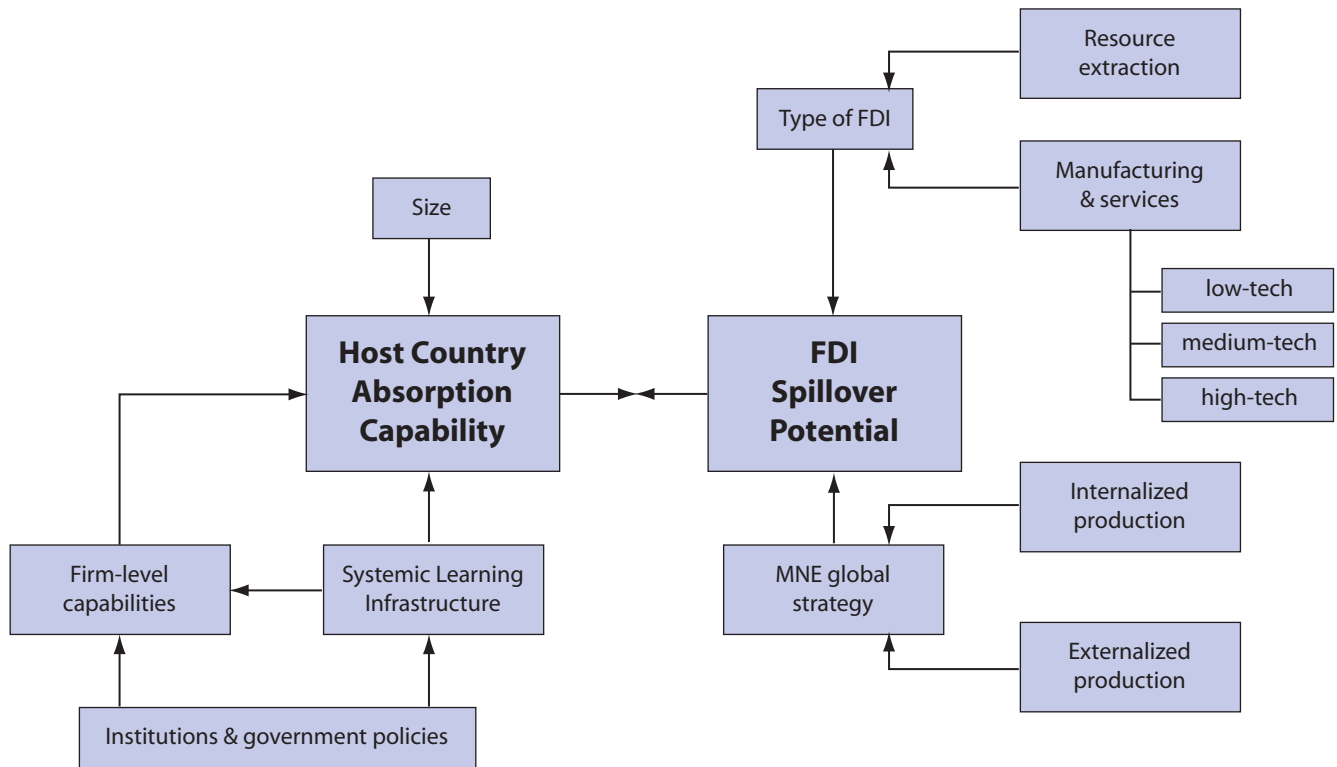
require complementary government action. Generally speaking, the promotion of effective linkages requires action in a broad range of policy areas, including trade policy (tariffs and non-tariff barriers and rules of origin), competition policy, technology policy (and IPR protection), education policy, labour policy and general development policy, apart from FDI policy and all associated laws and regulations (UNCTAD, 2001). Domestic local content requirements are generally found to be counterproductive (see chapter 6). In short, the success of an effective linkage policy depends on the strength of the country's overall national competitiveness as, for example, defined by Porter's diamond.

What are the conditions under which vertical linkages may occur? Linking foreign MNEs and local firms depends on a wide range of factors, ranging from the willingness of both parties to establishing linkages to (equal) levels of product sophistication and capabilities. In short, the tendency for vertical linkages to occur is contingent upon a mix of micro-level and macro-level factors (Jenkins and others, 2007). Some of the most significant factors, around which consensus seems to be emerging, are listed below (Altenburg, 2000; UNCTAD, 2001; OECD, 2005; Jenkins and others, 2007) and the interplay between these factors is illustrated in figure 7.2:

- Capacity of local SMEs. The existence of SMEs that have the potential to meet high MNE standards; the enhancement and improvement of which also falls under the factors listed below (training, upgrading). Availability and quality of local SMEs (e.g., technological gap between a foreign MNE and local SMEs) (Jenkins and others, 2007);
- Corporate Strategy. Encouraging MNEs to engage in linkages, as the MNE corporate strategy affects strength and nature of linkages (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); firm-specific perceptions and strategies (e.g., firms supplying a developing country's domestic market are more likely to develop linkages than firms that supply to global – more demanding – markets) (Jenkins and others, 2007);
- Absorptive capacity. The overall ability of the local economy to utilize spillovers from MNEs to improve productivity and efficiency (Girma and Görg, 2005) is, to a great extent, determined by an enabling or conducive environment (Mugione and Farinelli, 2010). For example, without such an enabling environment, technological gaps

**Figure 7.2**

**Interplay between host country's SME absorptive capacity and FDI spill over potential**



Source: Paus and Gallagher, 2007.

between foreign and local firms are too large for spillovers to successfully materialize. A conducive host country's business climate creates opportunities and encourages both the foreign and domestic private sectors to improve their technological, innovative and productivity capacities. It facilitates foreign investment into the host country and simultaneously strengthens the competitiveness of the local private sector and industrial base;

- Circumstantial factors. A useful framework in this context explores the determinants of spillovers and the formation of linkages between MNEs and local firms and SMEs by investigating the spillover potential of foreign MNEs, on the one hand, and the absorptive capacity of local agents (i.e., SMEs, firms and workforce) on the other hand (Farole and Winkler, 2014). So-called "circumstantial factors", to a great extent, determine the success of the formation of linkages and mediation of spillovers. Designing incentive instruments geared towards linkage-building needs to anticipate these factors.

The circumstantial factors that collectively constitute an enabling environment in the host

country affect characteristics of foreign investors, domestic investors and their absorptive capacity as well as the transmission channels between MNEs and the local economy (e.g., backward linkages, forward linkages, linkages with technology partners, linkages with competition, human capital effects and demonstration effects). Circumstantial factors may influence any of these three elements and, consequently, the functioning, direction and depth of spillover effects (Farole and Winkler, 2014);

- Ownership structure. In the case of a greenfield FDI (i.e., a new physical project) vertical linkages are less likely than in the case of M&As, strategic partnerships and joint ventures, as the MNE can materialize existing supplier relationships through its local partner (Javorcik, 2004);
- Ownership nationality. FDI originating from countries that have a closer cultural and/or geographical proximity to the domestic economy have a greater propensity to generate linkages than FDI originating from countries that have a greater cultural and/or geographical distance with the domestic economy (Görg and others, 2009; Lorenzen and others, 2020);

- FDI motive. Capital-intensive FDI projects (e.g., resource-seeking FDI) are less likely to generate vertical spillover effects as opposed to more labour-intensive FDI projects (e.g., strategic asset-seeking FDI, efficiency-seeking FDI and, to a lesser extent, market-seeking FDI). This is particularly challenging in developing countries, which usually lack the resource base and a sufficient domestic market size for further internal expansion (UNCTAD, 2011) and where the risk of MNEs being de-linked from the local economy and SMEs and operating as isolated enclaves is relatively high. Firm- and industry-specific risks, costs, opportunities and benefits play a role (Jenkins and others, 2007);
- Policy support. Last, available conducive policy environment and investment facilitation support is important (e.g., supportive policy framework and incentives) (Jenkins and others, 2007; UNCTAD, 2001).

An enabling environment is the overarching prerequisite for policies to strengthen FDI attraction, absorptive capacity and linkage-building which, in turn, foster linkage formation, deepening and sustainability. A conducive business environment is built on mutual interests of foreign MNEs and the domestic private sector, and needs to be developed in a holistic way. Government policies should thus not only focus at firm-level interventions, but also at

improving the general enabling business environment as well as at interventions that contribute to deepening linkages.

## B. Forging linkages: Policy tools

Targeted government interventions are necessary to ensure that favourable conditions are created or existing favourable conditions can be utilized effectively by prospective linkage partners. Some specific policies that have a proven track-record of facilitating linkages and subsequent productivity (and other developmental) spillovers are presented below.

First, specific linkage programmes implemented by Governments have played an important role in various countries, but their success has been very country- and environment-specific as well as dependent on the level of political commitment, the strength of 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 7.3 provides examples of different kinds of linkage programmes that have been offered in South-East Asia.



### Successful MNE-SME linkage programmes in Malaysia, Singapore and Thailand

Numerous countries in the South-East Asia region have put in place a range of policies and programmes designed to raise the capabilities of domestic firms and deepen linkages between foreign MNEs and local SMEs (UNIDO, 2018). While there is significant variation in the types of MNE-SME linkage programmes offered in ASEAN countries, only a few countries have been really successful in developing effective linkages on specific industries. Malaysia in the electronics sector, Singapore as a global innovation hub and Thailand in the automobile industry provide perfect examples of how countries should implement comprehensive linkage policies for actively embedding their SMEs in global value chains. 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. Established investors can benefit from the Industrial Linkage Programme (ILP) and the Global Supplier Programme (GSP), both of which provide incentives to MNEs 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. As a result of the ILP, a number of local food processors have become successful suppliers to retail MNEs. Tesco, for example, relied on Malaysian food processing SMEs for its 60 stores nationwide and their millions of customers. As of 2020, more than 80% of Tesco own-brand products were sourced and manufactured by local SMEs, and brought 12 new SMEs into its fold as part of its campaign to promote the local business industry.<sup>4</sup> On the other hand, the GSP provides financial and organizational support to MNEs, if specialists from their foreign affiliates are seconded to local firms (for up to two years) for the purpose of local upgrading. Under the GSP, training programmes are implemented in collaboration with regional centres and institutes like the Penang Skills Development Centre (PSDC). For example, the PSDC encourages local firms to cluster around foreign affiliate customers and devises training courses when skills gaps are detected, with foreign affiliates providing the necessary expertise.

<sup>4</sup> SME Asia. Available at <https://sme.asia/tesco-malaysia-puts-a-spotlight-on-sme-suppliers-this-holiday-season/>

**Box 7.3** (continued)

In Singapore, the Government has long promoted technology transfer and other linkages between MNEs and SMEs. 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 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 MNEs. 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 (EDB).

From its inception, the LIUP has helped to support the transfer of technology, marketing and business process knowledge from MNEs to domestic SMEs. Under the programme, MNEs 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 the second stage, new products and processes are transferred to the SME. The third stage envisions joint research and product development with MNE partners. Essentially, 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 MNE and their suppliers. By the mid-1990s, LIUP had already recorded many successes. For example, studies by 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 MNEs, 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. LIUP continued to expand over the decade, and by 1999, there were 670 local vendors, 30 MNE affiliates and 11 large local organizations participating. Nevertheless, LIUP’s contribution to the upgrading of SME’s technical capabilities remained below expectations. Local firms raised concerns over the sustainability of the relationships established since the localization of inputs was less of a priority in an increasingly costly and resource-constraint economy. Therefore, LIUP was subsumed in 2010 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. PACT promotes productivity improvement by existing suppliers, encourages the localization of existing product lines through supplier upgrading, and provides incentives for new product introduction through investing in, and supporting innovation by SMEs. PACT works with MNEs and large local companies to identify and implement collaborative projects with local SMEs, which go through different stages of product development together supported by public cost-sharing arrangements.

As such, PACT is regarded as an effective tool to deepen FDI linkages in Singapore. In the past decade, since its first introduction, more than 1,500 companies, involved in more than 280 projects, have reportedly benefitted from the scheme, while 16 new partnerships between suppliers are currently being discussed. It represents a significant evolution from the LIUP approach.

In Thailand, the Board of Investment (BOI) plays a key role for linkage policies. As an IPA, the BOI is the first point of contact for foreign investors and is charged with linking foreign MNEs with local companies through BOI’s Unit for Industrial Linkage Development (BUILD), which has been upgraded to the Industrial Linkage Development Division (ILDD), under BOI. The ILDD provides many key services: (a) providing information about subcontracting opportunities, notably via its online database Thailand Supporting Industry Database (TSID); (b) sourcing and business matching services; (c) assistance to local SMEs to achieve industrial standards required for entering into productive subcontracting arrangements; and (d) the organization and coordination of workshops, networking forums and exhibitions to provide in-depth information and help support local SMEs to be part of global supply chain of the growing next-generation industries.

In addition, ILDD organizes other local activities that support business linkages as well as connect the supply chain of parts manufacturers such as the Vendors Meet Customers (VMC) Programme. The VMC Programme was established to stimulate domestic sourcing of parts and components. BOI acts as a broker to match buyers or assemblers and vendors or suppliers. The programme arranges for suppliers to visit a buyer’s factory. Such visits enable potential suppliers to learn and receive insights on buyer’s procurement selection criteria as well as specific know-how on product manufacturing. 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.

*Sources:* BOI Thailand; MIDA; UNCTAD, 2001 and 2011b; OECD, 2018; UNIDO, 2018; World Bank, 2019; OECD-UNIDO, 2019; and See, 2020. Available at <https://www.businesstimes.com.sg/government-economy/singapore-government-expands-support-for-precision-engineering-firms>

Second, online platforms are a quick and effective way of promotion and the facilitation of investment processes. E-commerce platforms can facilitate the entrance of SMEs into global value chains, so that cost is lowered significantly, digital infrastructure enhanced and thereby an array of opportunities

created (Koreen and Cusmano, 2019; Kumar and others, 2020). See box 7.4 for a successful example from the Lao People's Democratic Republic. Malaysia has also developed a successful online SME policy hub (<https://www.smeCorp.gov.my/index.php/en/about/2015-12-21-08-40-32/orc>)



#### Lao People's Democratic Republic Plaosme e-commerce platform

The Lao People's Democratic Republic (Lao PDR) is encouraging the development of an e-commerce platform to improve SME linkages to Asian and international markets. A key initiative is Plaosme (see <http://www.plaosme.com>), an e-commerce platform launched in 2017 to support Lao SMEs in connecting with foreign investors. The platform, initiated by the Lao PDR Ministry of Industry and Commerce (MOIC) and the Lao National Chamber of Commerce and Industry (LNCCI), provides useful information about online trading for businesses in the Lao PDR via the online trading operator as well as promoting this operator as the national online trading channel. In addition, information about products and producers, business matching, workshops and other important activities are available on the website.

Plaosme has the following key objectives: (a) encourage and facilitate trade and investment between Lao PDR SMEs and ASEAN; (b) help SMEs export within and beyond ASEAN; (c) create a conducive and transparent regional trading environment in ASEAN and encourage the use of ASEAN Free Trade Area (AFTA) and related free trade agreements (FTAs); and (d) equip SMEs with the tools and resources that will enable them to compete internationally. The website also has three components: (a) a connection portal to help SMEs connect seamlessly; (b) online-enabling tools to help SMEs know if their products are covered by an FTA, how to qualify to use an FTA and how to receive marketing support; and (c) hands-on support to provide training and marketing assistance to SMEs.

Use of the marketplace is accelerating, with the number of registered companies increasing from 48 in February 2018 to 600 as of December 2020, offering close to 1,700 products and services for sale.<sup>5</sup> Ultimately, Plaosme.com aims to improve the resources available to SMEs, expand their customer base via digital trading and enhance their ability to integrate with global value chains. Essentially, Plaosme creates an ecosystem around SMEs, thereby producing a multiplier effect in this key segment of the economy.

Sources: OECD, 2018; UNCTAD, 2018; and Plaosme.com.

Third, as part of supply-chain management, MNEs often have supplier development programmes that local companies can access. Altenburg (2000) proposed the following measures to develop local suppliers. Supplier development policies should:

- Focus on voluntary measures to support the local supplier base, rather than on imposing 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.

Fourth, 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

<sup>5</sup> See <https://eccil.org/news/press-conference-on-national-e-commerce-platform-to-support-lao-smes/>



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 MNE within its global strategy with regard 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 in order to arrive at an end-product assembled and/or marketed and sold by the lead MNE. It has therefore been proposed to involve MNEs in cluster programmes and integrate them in clusters, for example, within the context of special economic zones (see chapter 5) (Yehoue, 2005).

Locational factors and policy reforms necessary for the attraction of FDI and related clusters can be costly, particularly for developing countries. Governments usually trade off the benefits of FDI vis-à-vis the potential cost of the policy reforms. However, if the policy reform is strong enough to trigger a ‘big push’ of domestic and international investments, this initial cluster will likely be able to compensate for the cost. The subsequent dense network of domestic and foreign firms will further even out policy-related distortions and continue to lure FDI into the location (Yehoue, 2005). The impact of clusters on internationalization and, interestingly, Industry 4.0 are well-explored and supported in the literature (Götz, 2020).

However, the exact effect of FDI on cluster formation, productivity and overall development hinges upon a variety of factors and the nature of the policy environment; clusters should therefore be viewed holistically, in connection to other policy measures and the wider economic development plan (Gugler and Brunner, 2007). Cluster formation can be supportive for a variety of other policy measures – it facilitates information delivery, match-making, related joint-ventures and, thus, local supplier development. For an in-depth analysis and discussion of clusters, consult Yehoue (2005), Gugler and Brunner (2007), Iammarino (2018) and Götz (2020) for critical discussion.

Fifth, 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 MNEs as next-tier FDI (Moran, 2015). While these SMEs obviously pose competition challenges to 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 MNEs were followed by their own suppliers from Japan. These

next tier smaller supplier MNEs have increasingly entered into joint ventures with domestic suppliers and, in the process, upgraded the latter’s capability.

It must also be mentioned that vertical linkages between MNEs 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 MNEs are usually smaller in size than the lead MNEs – 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).

Finally, selected international agencies provide matchmaking programmes such as ITC’s Value-Added to Trade programme package solutions, which helps SMEs to provide a differentiated and value-added offer as well as address production- and logistics-related difficulties in getting products to market. A number of international organizations provide supporting programmes for SMEs that can be used by Governments to inform policy decisions in order to improve linkages:

- Intracen MSMEs programme. Available at <http://www.intracen.org/itc/goals/connecting-to-value-chains-SME-competitiveness-diversification-and-links-to-export-markets/#sthash.uAnci3E0.dpuf>
- UNIDO Subcontracting and Partnership Exchanges (SPXs). Available at <http://spx.unido.org/spx/Default2.aspx>
- UNCTAD EMPRETEC Business Linkages Programme. Available at [https://empretec.unctad.org/?page\\_id=51](https://empretec.unctad.org/?page_id=51)

## 1. Conclusion on forging linkages

Last, as policy success hinges upon precise tailoring and targets as much as continuous review, below some focus areas are suggested which can be used to review linkage programmes in general:

- Description and structure of the programme;
- Who runs the programme(s);
- Institutional context, collaboration and embeddedness within the wider economic strategy;
- Objective of the programme and why was it set up;
- Activities under the programme, how do they work?
- Different policy instruments and incentives used;
- Target beneficiaries of the programme, who is it for (who is eligible);

- The sector of focus and geographical market focus;
  - The role of incentives, including modality, mechanisms for financing etc.;
  - Market failures/challenges tackled by the programme;
  - Challenges faced in setting up, implementing and running the programme(s);
  - Programme results, major achievements and examples;
  - What are the lessons learnt, what can be improved and what advice can be derived?
- Key success factors for the programme, the range of its impact and effectiveness;
  - Circumstantial /contextual factors;
  - Programme administration and budget – how is it financed?
  - Monitoring and evaluation metrics and evaluation tools and instruments;
  - How does the future look like for the programme(s)? Are you exploring other programmes? What changes need to be implemented to make the programme more effective.

### C. Discussion questions

1. 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?
2. 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?

## Part III

# Promotion and Facilitation of Sustainable FDI

## CHAPTER



# Investment promotion and attraction: Organizing for success

## A. Investment promotion agency roles and functions

While a conducive investment climate is essential for attracting FDI, countries have also increasingly competed through active investment promotion, targeting and facilitation strategies. For that purpose, most countries have established Investment Promotion Agencies (IPAs) with various mandates and institutional set-ups. This chapter focuses on the investment promotion organizational and institutional structures of IPAs as well as their goals, objectives and missions.

IPAs are usually established using separate Acts in order to keep investment laws concise (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 8.1 provides some examples of the legal basis and functions of some Asia-Pacific IPAs. In the annex of this chapter a complete list of the legal basis of all regional ESCAP and associate member States' IPAs can be found.



### Examples of the 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. The Act mandated BOI for providing diversified promotional and facilitating services to accelerate Bangladesh's industrial development. 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 (see <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 is composed of senior ministers from related government agencies. The Cambodian Investment Board (CIB) and the Cambodian Special Economic Zone Board (CSEZB) are CDC's operational arms for private sector investment. CDC/CIB undertakes basic investment promotion and facilitation services, e.g., it provides information services, processes and approves investment applications and grants incentives (see <http://www.cambodiainvestment.gov.kh>).

In **Georgia**, the Georgian National Investment Agency (Invest in Georgia) was established in 2002 as a Legal Entity of Public Law (LEPL), an 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, the 1996 Law of Georgia on the Investment Activity Promotion and Guarantees. In 2015, the agency moved to the direct supervision of the Prime Minister and is the only official state agency responsible for promoting and facilitating FDI in Georgia. The agency plays the role of moderator between foreign investors and the Government of Georgia. It undertakes active investment promotion, provides information and comprehensive aftercare services and facilitates the search for local partners (see <http://www.investingorgia.org/en>).

In the Republic of Korea, the Foreign Investment Promotion Act (FIPA) is the basic law pertaining to foreign investment. The Act established "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) (see <http://www.investkorea.org> and <https://www.kotra.or.kr>).

Sources: National IPA websites.

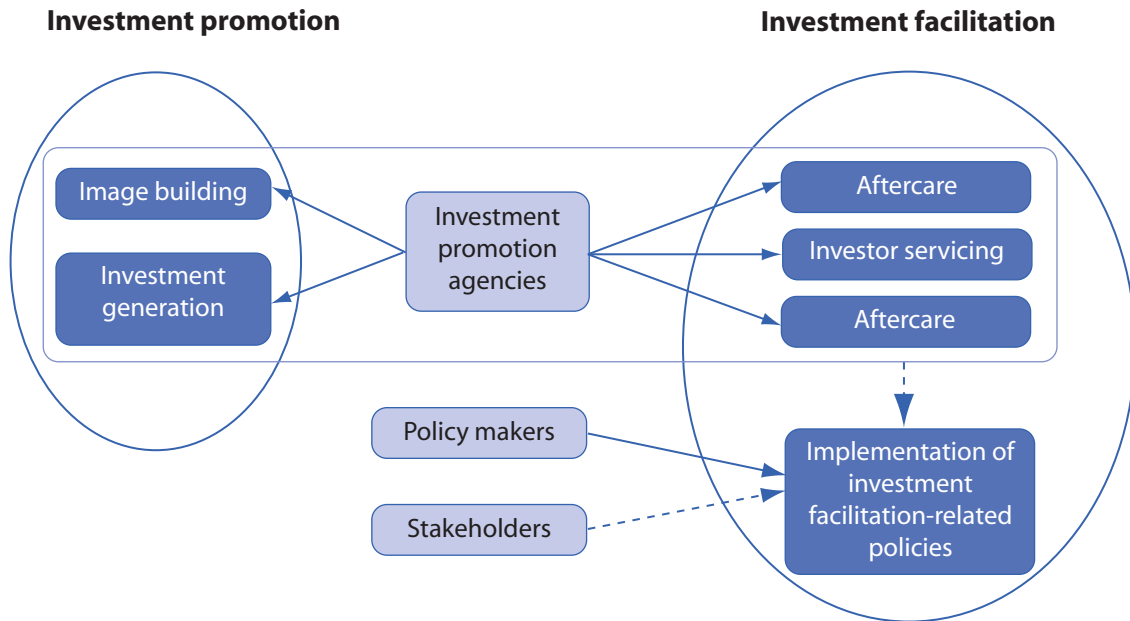
Essentially, the IPA is an intermediary between the investor and host country, through investment promotion and facilitation. However, a clear distinction needs to be made between investment promotion (pre-investment phase) and investment facilitation (post-investment phase) (figures 8.1 and 8.2).

The key functions of an IPA fall into seven main categories (as explained below) with a primary focus on four of the categories (figure 8.2). IPAs need to optimize these seven functions in order to achieve maximum results. Each of these functions plays a unique role in the different stages of the investment cycle. Strategy, organization, coordination, and research and intelligence are the underlying principles of key IPA activities (van den Berghe, 2018).

1. **Image building and marketing:** One of the core functions of an IPA is image-building and marketing. This is associated both with creating awareness of the IPA's role and coverage area among potential investors, and providing marketing and promotion materials in the country's investment climate for investors. Marketing serves as an "awareness creation tool" and aims to build an attractive image of the host country. Different marketing techniques exist to accelerate the process of image building and place branding.
2. **Investor targeting:** Targeting investors is a frequently applied approach that allows for the efficient utilization of limited resources based on prioritization. It entails both attracting specific

**Figure 8.1**

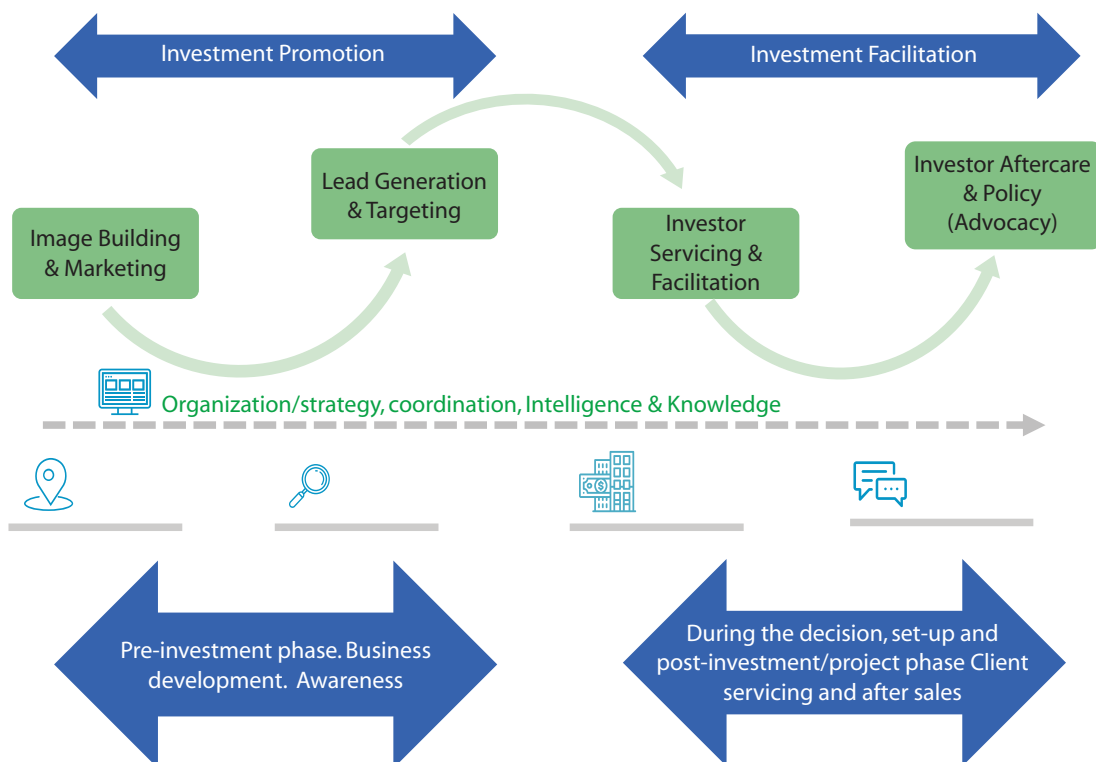
**The difference between investment promotion and facilitation**



Source: OECD. Available at <https://www.oecd.org/investment/Towards-an-international-framework-for-investment-facilitation.pdf>

**Figure 8.2**

**Investment promotion life cycle, framework, and key IPA activities and functions**



Source: van den Berghe, 2018, and partly based on Loewendahl,, 2001, VCC, 2009 and UNCTAD, 2014.

industries and companies in specific industries. This involves the identification of niche businesses or businesses that possess competitive advantages in an 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 staying in contact with these investors on a sustained basis (see next chapter).

3. **Investment servicing (facilitation):** Truly realizing investments from leads that have been generated by investor targeting requires active investment facilitation, the key objective of which is to convert an investment inquiry into an actual investment. Successful approaches include appointing key accounts or key management for every serious inquiry, lead or potential project. Understanding the requirements of investors, providing appropriate information, arranging site visits, establishing one-stop shops and developing ready-made tailored packages are essential steps to achieve effective investor facilitation.
4. **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 building 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 to formulate policy recommendations accordingly.
5. **Strategy and organization:** To successfully conduct the above four key functions and activities, a clear and comprehensive understanding of 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) is required. It also requires the identification of key sectors in order to target inward investment, organize an IPA's best structure and attract competent staff to deliver all activities successfully.
6. **Organization and coordination:** A Government needs to create an effective IPA that is responsible for attracting inward FDI. 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 and coordination with private and public

stakeholders, such as subnational IPAs and national level government agencies and ministries, are crucial in formulating a coherent and consistent FDI policy approach (Zanatta and others, 2006).

7. **Intelligence and knowledge:** In order to successfully build an investment promotion and marketing strategy it is important for all IPAs to develop a knowledge base, and to collect intelligence and data on the key priority sectors as well as on the companies targeted by the IPA. In addition, for IPAs it is critical to stay up-to-date on global and regional trends in FDI best practices of IPAs etc. Intelligence and knowledge accumulation as well as databases are an important activity of any effective IPA.

The focus on these activities and functions varies from country to country depends very much on the countries' level of development, experience with FDI and the number of years an IPA has been successfully operational. IPAs in more developed countries with already significant inflows of FDI tend to focus on the promotion of higher value-added investment, aftercare, investment retention and expansion, and FDI-local economy linkage programmes. In contrast, IPAs in developing countries tend to focus more on traditional investment promotion and image-building activities. Some IPAs have wide-ranging functions. For example, Papua New Guinea's IPA has diversified roles and functions, including export promotion.

The next section focuses on the organizational principles of IPAs.

## **B. Defining organization principles of an Investment Promotion Agency**

Attracting investment is a challenging, resource-intensive activity. It requires a diverse range of skills and a high level of professionalism and commitment. Realistically, defining the organizational principles such as vision, mission and goals, regarding investment climate, available resources and skill are crucial to creating shared values and differentiating IPAs from other institutions.

### **1. Vision and mission statement**

Each IPA should consider the vision for its organization and/or location. A vision is a concise but clear future-oriented statement of what the organization intends to become and achieve. Most visions these days refer to sustainable development and expected benefits of FDI to the people.



The mission statement should be an inspiring statement outlining how the vision will be achieved. It should be simple and concise.

In practice, visions and missions are often overlapping and there is a close mutual relationship. For this reason, some IPAs may choose to only have a mission statement and no vision statement. The annex of this chapter provides a list of visions and mission statements of all IPAs in the region.

## 2. Goals and objectives

Goals are general statements of what an IPA wants to achieve and thus need to be embedded in its vision and mission. Goal-setting is the major outcome of strategic planning.

'Objectives' and 'goals' are often used interchangeably, yet they can be distinguished. Objectives are specific, quantifiable, time-sensitive statements of what is to be achieved and when. Objectives should be tailored to meet the goals. Both should be SMART to be effective:

- **Specific:** Precise about what is to be achieved to meet the vision and mission;
- **Measurable:** Simple and 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 finishing dates and adaptable.

Typical goals for IPAs include: delivery of high-quality investor services; providing marketing and promotion material to a specific location; research and data gathering; offering (web) events and investment seminars as well as a high-quality website; and tracking and tracing investor inquiries and assisting in site visits. However, these "goals" often refer to services and activities actually provided by the IPA, rather than goals according to the SMART criteria.

An example of a useful SMART goal is to expand FDI in (sector) and (location) by x% (end date). Goals can also refer to the expansion of employment, business linkages or transfer of technology or given amount of capital inflows or any other higher economic goal from FDI. However, in order to enhance the contribution of an IPA in promoting sustainable FDI goals should reflect sustainability, and contain both quantitative and qualitative aspects related to sustainability (VCC-WAIPA, 2010).



### Examples of IPA SMART goals

#### **Bangladesh Investment Development Authority (BIDA) key objectives (see <http://bida.gov.bd>):**

- In order to support domestic technology development and increase the attractiveness of the country's ICT sector, eight IT parks across the country were to become operational by 2021 and will create 30,000 new employment opportunities. Furthermore, 1 per cent of the country's GDP will come from the software and IT services sector by 2024.

#### **Sri Lanka's Board of Investment key objectives (see [http://www.investsrilanka.com/about\\_us](http://www.investsrilanka.com/about_us)):**

- The apparel manufacturing sector export value of the country in 2019 was reportedly US\$5.2 billion and contributed to 44 per cent of the national exports, the Board of Investment has targeted expansion of this export value to US\$10 billion by 2025.

Sources: Websites of national IPAs

## 3. Client Charter

A Client Charter is akin to a "letter of engagement" informing potential investors about standards, and the delivery of products and services. It also indicates what the IPA expects from investors and sets targets for service delivery. In particular, the Charter sets out what the IPA will do for investors, how and 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; and its programme and service portfolio are tailored appropriately to client needs. Box 8.3 gives an example of a typical client charter.



### An example of a client charter – Malaysia Investment Development Authority (MIDA)

MIDA is committed to providing 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.

MIDA is committed to answering relevant enquiries and to completing the evaluation of applications from the date that complete information received, within the following stipulated time-frames:

- Enquiries received via website – two working days;
- Manufacturing Licence
  - Normal Track – four weeks;
  - Fast Track – seven working days;
- Post-incentives – six weeks;
- Incentives – six weeks;
- Tax exemption from Custom Duties – four weeks;
- Principal Hub – six weeks;
- Regional and Representative Office – four weeks;
- Expatriate Posts
  - Normal track – four weeks;
  - Fast track – seven working days;

Source: Available at <https://www.mida.gov.my/about-mida/client-charter>.

## C. Structure, organization and staffing of an effective IPA

To operate effectively, an IPA should essentially focus on its core activities, i.e., investment promotion, facilitation and aftercare. However, in some cases, IPAs have a broader mandate. Four (recent) developments are detailed in this chapter:

1. The status and position of the IPA or the institutional structure;
2. A discussion on whether investment and trade promotion as well as outward FDI promotion should be combined into one agency;
3. The role of subnational IPAs and collaboration with national IPAs;
4. Overseas representation and possible outsourcing of these activities.

### 1. Status and position

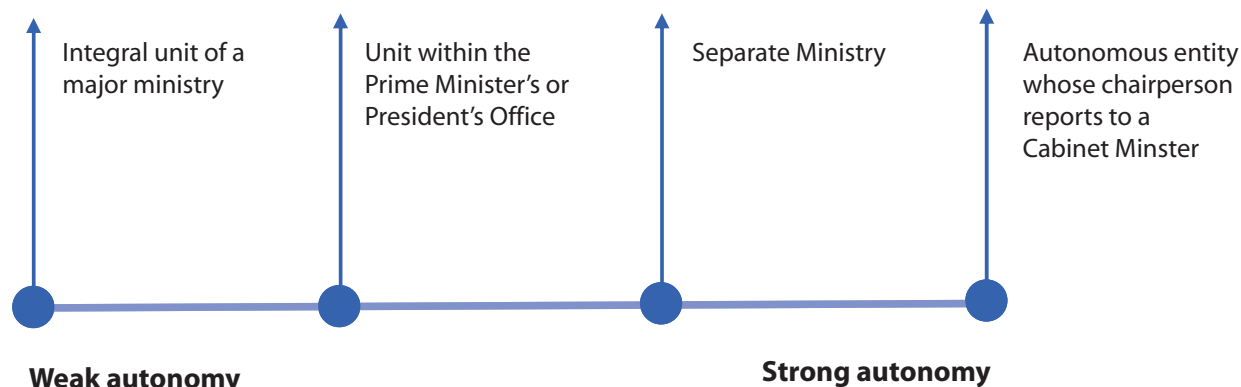
As discussed above, IPAs usually fall under the responsibilities of the ministries of economic affairs, industry, planning, trade and investment, finance or

foreign affairs. These ministries allocate the agencies' budgets and heads of IPAs consequently report to the respective ministry. For example, China's Investment Promotion Agency is hosted by the country's Ministry of Commerce, while Viet Nam's Foreign Investment Agency is hosted by the Ministry of Planning and Investment. The institutional set-up is important, as recent work has highlighted the fact that institutional quality affects FDI positively (Kurul and Yalta, 2017) and that underdeveloped institutions cannot capture the benefits of FDI effectively (Nelson, 2009).

Figure 8.3 illustrates four common types of IPA structures, and each structure has its advantages and disadvantages (see table 8.1). The right institutional structure for each country should be determined by the existing government structure and how the IPA will fit in. This differs from country to country, depending on the political environment, existing organizational structure, local government culture as well as available resources. The institutional structure that is selected will also determine the degree of autonomy the IPA enjoys – and therefore the degree of power.

**Figure 8.3**

**Spectrum of institutional IPA structure**



Source: van den Berghe, 2018.

**Table 8.1**

**Advantages and disadvantages of various types of IPA status**

1. Integral part of an existing ministry	
Advantages	Disadvantages
<ul style="list-style-type: none"> <li>The IPA's status within the Government is clear to other parts of the Government.</li> <li>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.</li> <li>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.</li> <li>In most cases, an IPA can be established within an existing ministry without the need for enabling legislation.</li> </ul>	<ul style="list-style-type: none"> <li>A ministerial office is unlikely to be well-suited to the business-oriented, initiative-taking style common to most successful IPAs.</li> <li>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.</li> <li>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, both from the public and the private sectors.</li> </ul>
<p>The Singapore Economic Development Board is the national IPA and was established under the Ministry of Trade and Industry. The Economic Development Board is one of nine statutory boards under the Ministry's purview.</p>	
2. Establishing the IPA in the office of the head of Government/State	
Advantages	Disadvantages
<ul style="list-style-type: none"> <li>Association with the office of the prime minister or president increases the status and potential influence of an IPA.</li> <li>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.</li> </ul>	<ul style="list-style-type: none"> <li>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.</li> <li>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.</li> </ul>

**Table 8.1** (continued)

<ul style="list-style-type: none"> <li>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.</li> <li>The IPA can probably be set up without the need for special legislation.</li> </ul>	<ul style="list-style-type: none"> <li>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 the private sectors.</li> <li>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.</li> </ul>
<p>Example: The Bangladesh Investment Development agency is placed under the supervision of the Prime Minister's Office to reflect the Government's vision that assigns high priority to private sector development in ensuring economic development.</p>	
3. Separate ministry	
Advantages	Disadvantages
<ul style="list-style-type: none"> <li>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.</li> <li>The IPA has its own minister to argue its case within the Government.</li> <li>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.</li> </ul>	<ul style="list-style-type: none"> <li>The IPA is 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.</li> <li>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.</li> <li>The IPA's public-sector status is likely to make it difficult to recruit executives with private sector experience.</li> <li>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.</li> </ul>
<p>Example: In Samoa, The Ministry of Commerce, Industry and Labour is tasked with the creation of an attractive investment climate for both local and foreign investors. Herein, the ministry actively promotes industry development and foreign investments in the country.</p>	
4. Autonomous agency	
Advantages	Disadvantages
<ul style="list-style-type: none"> <li>An IPA has a distinct identity, its own budget, and its own chief executive officer and board.</li> <li>It can be run with more flexible procedures than a government department;. It can hire staff from both the public and private sectors; and it can authorize needed expenditures.</li> <li>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.</li> <li>As a separate, accountable body, the IPA's performance is likely to be more open to parliamentary and public scrutiny.</li> <li>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.</li> </ul>	<ul style="list-style-type: none"> <li>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.</li> <li>This model often does not work effectively because the IPA is not given sufficient statutory power to approve investments, grant concessions and 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.</li> </ul>
<p>Example: The IPA of Sri Lanka has, since its creation in 1978, been incorporated as a statutory body with its own budget and board. While this IPA was initially confined to specific areas such as Export Processing Zones under the name Colombo Economic Commission, an Act passed in 1992 by the Parliament expanded its scope to cover the entire country, and the agency changed to the Board of Investment of Sri Lanka.</p>	

Sources: Multilateral Investment Guarantee Agency. Investment Promotion Toolkit, No. 2, Developing an Investment Promotion Agency, 2000; Daniel and Forneris, 2010; and national IPA website.

Some observed best practices on institutional structure are (Heilbron and Whyte, 2019):

- Autonomous entities or joint public-private institutions that have frequently been cited as best practice;
- Non-political and non-governmental IPAs achieve better results on stability and continuity in the institutional structure;
- Ideally an independent, stand-alone agency, focused on investment promotion, works best.

There are different schools of thought whether, in developing countries, the regulatory function should be located within or outside the IPA. When located within, the IPA often struggles to break out of its regulatory jacket and be effective at investment promotion – and investors are also wary of the IPA which makes it hard to provide effective aftercare services. In theory, located within would make it easier for the IPA to identify and remove investment obstacles, although in practice this often means conflict of interest. In summary, if the functions are combined, a very strong mandate, strategy and will be needed to drive investment promotion while maintaining a very clear separation from the regulatory functions.

It follows that an autonomous agency with legal identity and a high degree of operational independence

and granted sufficient statutory power, staff, resources and mandate, is potentially the most effective type of IPA (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. 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 sector members, the greater the IPA's effectiveness. As an autonomous body, it also has more authority to coordinate among line ministries and other agencies, in particular when it reports directly to a country's head of state or Government.

#### D. Combining other activities with investment promotion

There is a general consensus in the investment community that trade and investment promotion activities should be kept separate, but that responsible teams should be one unit. While there are arguments for combining them – for example, in Small Island Development States (see the Marshall Islands and the Maldives) where resource and budget constraints are limited – more often than not, trade and investment functions typically operate independently. Box 8.4 outlines several good and bad reasons for merging investment and export promotion activities.



#### Box 8.4 Institutional reforms: The good and bad reasons for merging mandates

##### Good reasons to merge:

1. To improve coherence of public policies and simplify the system;
2. To help pinpoint synergies to create added value;
3. To bolster efficiency that leads to joint operations, shared tools (in both directions), and sharing of international networks;
4. To increase the agency's advocacy power through enhanced visibility;
5. To encourage the development of new skills and offer new perspectives for employees.

##### Bad reasons to merge:

1. To create a one-stop shop for exporters and investors – two targets with different service requests;
2. To rationalise budget and personnel – a merger does not necessarily represent a source of savings, especially at the beginning, when taking into account the cost of the merger itself;
3. To simplify human resources management with a unique profile of workers suitable for both operations, since the roles are complementary but not the same, and each call for specific operational profiles;
4. To develop a single overall mission including both export and investment operations.

Sources: OECD, Business France, 2018 and OECD, 2019.

Given the rise in OFDI from many developing countries (see chapter 3), some countries may consider combining inward and outward investment promotion activities. Recent surveys of IPAs suggest that around 60 per cent of IPAs globally have also been tasked with outward FDI promotion (Heilbron and Kronfol, 2020). However, combining inward and outward investment in the same organization is unlikely to be the best institutional structure because it diminishes the impact of the FDI (Lim 2018). Moreover, combining OFDI activities with the IPA activities has a clear danger of distracting an IPA from its core mandate. Nevertheless, one exception is when IPAs have proved ideal places for Governments to incubate new investment-related functions before transferring – once a concept is proven – to a more appropriate institutional home (Heilbron and Whyte, 2019).

In general, outward FDI promotion is better within specialized development and trade promotion organizations implementing an “internationalization of domestic firms” strategy. For example, export promotion agencies (EPAs) are a natural institutional home for OFDI support, given that domestic firms often progress from exporting to investing overseas (Heilbron and Whyte, 2019).

## 1. The role of subnational IPAs

Many countries (especially geographically large countries) have subnational IPAs that operate next to, or somewhat independently from national IPAs. The capability of subnational regions and cities to promote and facilitate foreign investment is very important for the success of a country’s FDI attraction and the embedding of investments into the local economy to reap the strongest possible economic development benefits. There are three key reasons why the subnational level is so important, according to the InterAmerican Development Bank (IDB, 2018):

1. The local level is critical for site selection decisions: While investors may conduct an initial country-level screening to identify attractive investment destinations, the investor will quickly drill down to the local level, as it is at that level the availability of land, property, skills, infrastructure, customers and suppliers will be assessed. In most countries, incentives are also not nation-wide, but are regional or location-specific. The quality of investment facilitation services provided at the local level can be critical

to securing FDI. Once invested, investment after-care services are also ideally provided at the local level, especially in medium and large-sized countries, to be able to meet investors regularly and provide on-the-ground support and networks. This is equally important for securing re-investment projects;

2. The local level is critical for economic development: It is the level where supply-chain linkages, cluster development and skills development take place;
3. Each subnational region has unique strengths to promote. The diversity of regions within countries that may be specialized in specific sectors can provide specific investment opportunities for investors often with different economic development objectives reflecting the economic and social situation of each region. It is challenging, if not impossible in large countries, for a national IPA to have comprehensive and constantly updated information on every region and investment opportunity across the country, and to promote all these regions and opportunities to potential investors. Typically, most national IPAs tend to promote their strongest regions and those that align with their national sector targeting strategy, as this will secure the strongest results for the IPA. Very few national IPAs have specific targets for subnational dispersion of FDI (one of a few examples would be IDA Ireland). Cities and specific areas within a country therefore often need their own investment promotion capacity to be able to complement the activities of the national IPA and directly promote their location to investors.

Hence the coordination between the national IPA and the subnational IPAs is crucial. Regular informative meetings, events and training can be part of this coordination programme – see, for example, Invest Canada regular nation-wide FDI training programmes (IDB, 2018).

Subnational IPAs can be subsidiaries of the national IPA but often they are not (box 8.5). Competition among IPAs representing different regions can be detrimental to a country’s overall development (Zanatta and others, 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.



### An example of a subnational IPA – Danang Investment Promotion Centre, Viet Nam

Danang Investment Promotion Agency (IPA Danang), established and directly managed by the Danang People's Committee, is a government agency responsible for promotion, attraction and facilitation of domestic and foreign direct investment into Danang City.

IPA Danang provides a wide range of free, confidential and customized services to investors, serving as a bridge between the investors and the municipal authorities. Its main responsibilities are:

1. Providing organizations, enterprises and investors with information on market, legal regulations, policies, investment procedures, partners, socio-economic development potential and investment opportunities in Danang;
2. Contacting and referring to other local government departments and agencies specialized on land and infrastructural facilities required to implement investment projects;
3. Assisting investors with investment procedures before, during and after the project is granted, applying for registration of investment and business certificates as well as post-certificate in accordance with the law;
4. Receiving, synthesizing and submitting investors' proposals and recommendations to relevant authorities for settlement;
5. Organizing promotional activities on investment environment and opportunities in Danang (conferences, workshops, seminars, forums, fairs and exhibitions etc.) and business linkages programmes;
6. Organizing professional training programmes on investment and business related to legislation and skills.

IPA Danang always accompanies investors and provides quality assurance services to meet their various needs.

Source: Available at <http://www.ipc.danang.gov.vn/en/web/ipc-english/our-mission>

## 2. Overseas representation and outsourcing

For IPAs 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. Increasingly, IPAs outsource investment promotion activities to specialized lead generation consultancy firms, which are more performance-oriented and can help generate large cost-savings. The consulting firms often have a bigger team with stronger networks that would take the IPA many

years and a major investment to replicate. Hence, in the United States almost all Economic Development Organizations (EDOs) outsource their overseas representation and lead generation. Outsourcing of investment promotion activities has become one of the most pronounced trends in the industry recently (UNCTAD, 2020) and many IPAs in Asia-Pacific are also utilizing this model. For example, Investment Hong Kong's (IHK) overseas offices are mainly not its own but are with private consulting firms.

Table 8.2 provides an overview of the organizational models for investment promotion overseas.


**Organizational models for investment promotion overseas**

Model	Pros	Cons	Key success factors
1. Overseas offices set up by the IPA/EDO	<ul style="list-style-type: none"> <li>● Full ownership and control</li> <li>● Work exclusively for the IPA/EDO</li> <li>● Can get really well-trained in the value proposition of the location</li> </ul>	<ul style="list-style-type: none"> <li>● Very high cost</li> <li>● Slow and complicated to setup</li> <li>● Hard to close down or fire staff</li> <li>● Hard and costly to hire senior proven practitioners</li> <li>● Staff turnover is often high</li> </ul>	<ul style="list-style-type: none"> <li>● Lots of time and money – success takes 2 to 5 years</li> <li>● Hiring best candidates from the source market</li> <li>● Performance driven IPA culture and systems</li> <li>● Need full team in each office – not just 1 or 2 staff</li> <li>● Strong career paths so staff turnover is low</li> </ul>
2. Overseas representatives located in embassies	<ul style="list-style-type: none"> <li>● Quicker and cheaper to setup</li> <li>● Work exclusively for the IPA/EDO</li> <li>● Can be trained in understanding and communicating the value proposition of a country</li> </ul>	<ul style="list-style-type: none"> <li>● Often have a broad commercial role not just FDI reducing impact</li> <li>● No full team in the market</li> <li>● Embassies often not sales-focused</li> </ul>	<ul style="list-style-type: none"> <li>● Hiring the right person is key to success</li> <li>● Focusing only on FDI</li> <li>● Being able to utilize embassy resources</li> <li>● Attractive packages to retain talent</li> </ul>
3. In-market lead generation consultants (outsourced)	<ul style="list-style-type: none"> <li>● Very quick and cost effective to setup</li> <li>● Can quickly increase FDI pipeline</li> <li>● Have in-market business networks and primary corporate intelligence</li> <li>● Provides a full support team for all key in-market activities needed</li> <li>● Can be turned on and off as and when needed</li> <li>● Can be fired if they do not deliver</li> </ul>	<ul style="list-style-type: none"> <li>● Are generally short-term contracts (up to one year) so no long-term support to follow-up leads</li> <li>● Results are therefore around leads and number of meetings with potential investors and not FDI successes</li> <li>● As are short-term contracts, less opportunity to really understand the location value proposition and build long-term relationships</li> </ul>	<ul style="list-style-type: none"> <li>● Drafting a good Request for Proposal (RFP) for the work (needs to be realistic – project successes cannot be expected in short term contracts)</li> <li>● Ensuring the lead generator is well trained in the location value proposition</li> <li>● Ensuring adequate seniority and preparation of IPA/EDO teams making the in-market missions</li> <li>● Ensuring the IPA/EDO has a team and budget to follow-up effectively with investors long-term</li> </ul>
4. In-market FDI representatives (outsourced)	<ul style="list-style-type: none"> <li>● More cost-effective and quicker to market than own offices</li> <li>● Bigger resources and better networks and primary intelligence</li> <li>● Performance and results driven</li> <li>● Can be fired if don't deliver</li> <li>● Staff turnover of senior reps low</li> </ul>	<ul style="list-style-type: none"> <li>● Do not work exclusively for the IPA (can be a benefit as long as they do not work with a key competitor)</li> <li>● Typically, cannot get involved in sensitive political areas or incentives</li> <li>● Not fully integrated into the IPA</li> </ul>	<ul style="list-style-type: none"> <li>● Finding the right company that can operate as “one team” with the IPA/EDO home team and has proven ability to generate realized projects</li> <li>● Very effective reporting and evaluation systems</li> <li>● Performance based multi-year contracts to incentivize results (typically up to 20% of fee)</li> <li>● Familiarization tours to your location</li> </ul>



**Table 8.2** (continued)

Model	Pros	Cons	Key success factors
5. Fully managed office solution	<ul style="list-style-type: none"> <li>Recent trend especially with Covid-19</li> <li>Provides the same benefits of having your own office and team without the hassle and you can benefit from the capabilities of the consultant</li> </ul>	<ul style="list-style-type: none"> <li>Can be more expensive than doing it yourself but it is far lower hassle and faster to implement and the consultant maybe in a stronger position to do it for you</li> </ul>	<ul style="list-style-type: none"> <li>Finding the right consultant to setup the office and team</li> <li>Hiring the right senior manager</li> <li>Clear KIPs</li> <li>Utilizing the wider support that the consulting firm can provide</li> </ul>
6. No overseas market teams – all done at HQ	<ul style="list-style-type: none"> <li>Most cost-effective model</li> <li>Total control by the IPA/EDO at HQ</li> </ul>	<ul style="list-style-type: none"> <li>Makes it very challenging to meet companies on demand and with Covid-19 impossible</li> <li>Needs a big travel budget</li> </ul>	<ul style="list-style-type: none"> <li>Very professional IPA with country experts, language skills, corporate intelligence teams and travel most of year and work all time zones</li> </ul>

Source: Wavteq, 2020.

### 3. 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 many staff and resources. An IPA's staff should have a mix of private and public-sector backgrounds with foreign language capabilities. Educational or professional backgrounds in the IPA's priority sectors are also desirable (World Bank Group, OECD and UNCTAD, 2020). At a minimum, the IPA should have the following key positions (VCC, 2009):

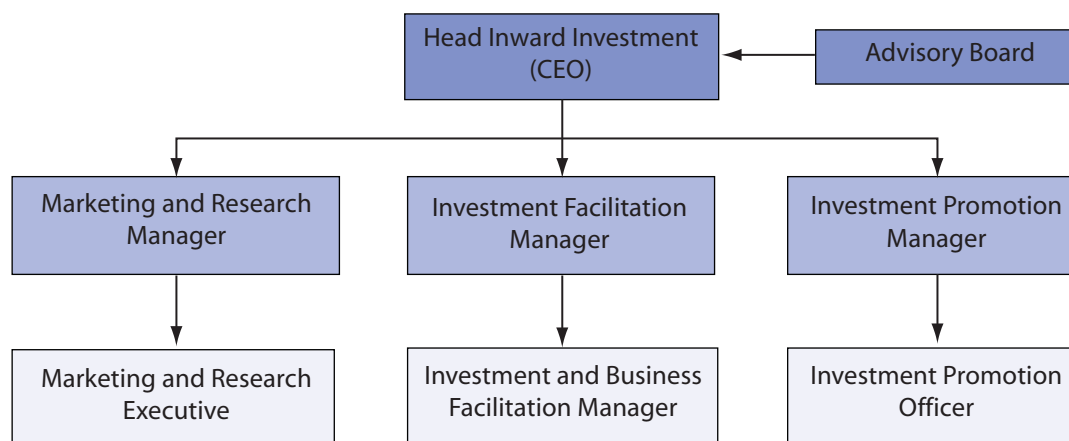
- Head of office: Chief Executive Officer;
- Investment Promotion Manager;
- Investment Facilitation Manager;
- Marketing and Research Manager.

If the budget allows, the IPA can add additional staff to support the work of the managers (figure 8.4). The marketing and research manager undertakes relevant research for investors and develops the website. This manager could also, over time, build a databank of information and facts about the country/location. He/she is also responsible for identifying, networking and building relations with other organizations and leading existing foreign and domestic investors. 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, as well as setting up new provincial operations and aftercare (VCC, 2009).



**Figure 8.4**

**Basic organizational structure of a small IPA**



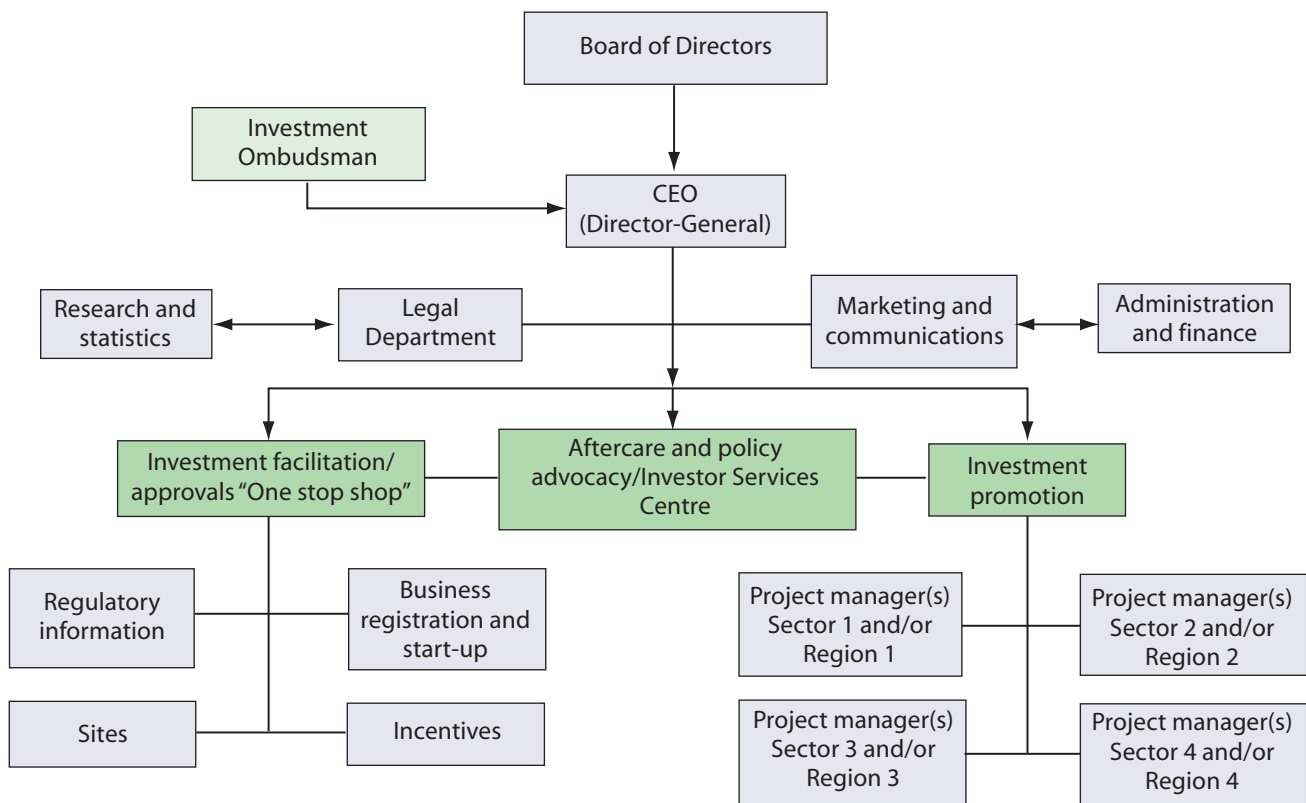
Sources: VCC, 2009; Investment Consulting Associates.

At a minimum, the national IPA should have 10-20+ full-time staff if it is an autonomous body, while a subnational or municipal IPA should have 10+ full-time staff. A small IPA will have limited staff and should be concerned with resource efficiency. In this case, the IPA's primary focus should ideally be facilitating investor inquiries, as these inquiries are from investors who clearly have an interest in investing and are considering various investment locations. The project manager should take the lead

in handling these inquiries, with support from an investment officer where resources allow (VCC, 2009). 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 8.5. VCC (2009) specifies the roles and functions of the various segments of the IPA.



**National IPA best practice organizational structure**



Sources: 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 the private sector. The Chairperson should be from the business community and well-respected, and should have no conflict of interest (not a 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 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. They should have fluency in English, a pro-active attitude and be understanding with media. They should have in-depth knowledge of international business and know-how for preparing and conducting meetings and strategic conversations with senior executives of major companies. They are

accountable to the Board (and through the Board to the sponsoring ministry) or a minister, and have 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 staff-wise;
- 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 typically headed 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.

The Marketing and Communications team plays a key role in the provincial IPA. Its members' responsibilities can include provision of promotional propositions, organizing and attending events, and developing a communication strategy. For small and medium-sized agencies, marketing also has research responsibility. Marketing therefore has a crucial role in supporting the activities of the project managers.

Research and statistics is a critical function and includes: (a) preparing statistics and collecting data for analysing (domestic, regional and global) investment trends; (b) tracking investment by type, origin, destination, amount, approved vs. realized etc.; (c) designing and maintaining FDI and location databases; (d) conducting research and data provision for individual investors; (e) identifying and profiling target investors; and (f) 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 licences that 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 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 IPA's role. 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.

IPAs can also play an important role in policy advocacy, which is directly linked to aftercare. The combination of access and understanding of business and political stakeholders puts IPAs in a unique position to advise the government on investment issues. 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 can engage in policy advocacy through frequent interaction with investors in order to identify any emerging or reoccurring problems and develop a policy agenda. In addition, public-private sector dialogues can help to guide policy recommendations together with established criteria on expected impacts of potential policy remedies.(UNCTAD, 2008).

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 of delivering aftercare. For larger organizations, project managers can be divided into regional or sector targeting teams, with dedicated managers for each region/sector being targeted. Project managers should act as account executives for individual investors.

Overall, the effectiveness of an IPA is determined by the skills of its staff. The staff require different skill sets depending on their specific role in the IPA. For example, marketing staff should have a degree 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 an 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. Generally, for standard investment promotion and facilitation, staff should have or develop the following skills:

- An excellent command of spoken and written business English and other languages of principal investors that are targeted (e.g., Japanese, Korean and Chinese for the Asia-Pacific region);
- Ability to use client-relation management (CRM) and client tracking for facilitation, aftercare and accountability;
- Ability to undertake competitive location benchmarking;
- Ability to undertake IPA benchmarking and improve IPA performance;
- Ability to 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;
- An understanding of foreign investors' decision-making processes and business life-cycle;
- An understanding of sustainability issues, national development plans and priorities, and a thorough knowledge of international principles of responsible business conduct;
- Ability to anticipate and satisfy investor enquiries;
- Ability to use advanced promotion techniques to generate investment leads;
- Ability to lobby and advocate improvement in the investment climate;
- Ability to undertake investor targeting by specific regions, industries and companies;
- Ability to establish and manage local linkages programmes;
- Ability 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 8.3 shows job descriptions and qualifications for two key positions in an IPA related to investment facilitation (rather than promotion). IPAs should also be equipped with some basic facilities, technologies and equipment, including:

- A central location that is easily reached by private and public transport;
- A dedicated telephone number with an extension for each staff member;
- A dedicated office with meeting space and appropriate signage on office and front of building;
- A networked computer system with advanced and up-to-date software and databases;
- Customer relationship management (CRM) system;
- A well-developed, attractive and interactive website – separate from, but linked to provincial/municipal government and national IPA sites;
- Translating and interpretation services.

#### 4. Budgeting and planning

The preparation of an IPA's budget requires a clear understanding of the essential cost items. These include (from most 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, including a contact relations tracking system;
- Marketing materials development and printing, including contracting firms specialized in FDI for this aspect and website development;
- Company car for taking investors on site visits;
- Telephone (local and international), postage, stationery and printing costs;
- Travelling locally and internationally to meet investors, stakeholders and attend industry events;
- Translation into English of important legal and promotional documents;
- Purchasing/subscribing to key sources of data and company intelligence (for example, WAVTeQ, fDi Markets, Eikon).

In addition to these more traditional costs, travel restrictions and new modalities of working in the context of the COVID-19 pandemic have highlighted that it is essential that IPAs also have access to, and are well-trained in using cloud-technology and a


**Job descriptions and qualification for two key IPA positions**

Investment Centre Director	
Job description	Qualifications
<ul style="list-style-type: none"> <li>● Provide overall direction to the Investment Centre, reporting to Chairman; Prepare annual work plan.</li> <li>● Assign clients/prospects and tasks to staff;</li> <li>● Co-ordinate with other units in provincial/regional government (e.g., IT and web services, operational departments);</li> <li>● Responsibility for dialogue with business associations and other external stakeholders;</li> <li>● Lead client-facing promotion, facilitation and aftercare activities;</li> <li>● Set and oversee research agenda and activity;</li> <li>● Evaluate staff performance and prepare individual staff training plans.</li> </ul>	<ul style="list-style-type: none"> <li>● A Master's degree in business, economics, management or related discipline.</li> <li>● At least seven years' experience in private business or a state-owned enterprise, focusing on marketing, public relations, investor relations or a similar area.</li> <li>● Experience with customer relationship management (CRM) systems.</li> <li>● Fluency in written and spoken English; other languages (Chinese, Arabic, Turkish, Korean, German, French) an asset.</li> <li>● Proven ability to manage professional staff; training experience a plus.</li> <li>● Knowledge of transport and logistics, energy, technology and/or manufacturing industries a plus.</li> </ul>
Senior Investment Officer	
Job description	Qualifications
<ul style="list-style-type: none"> <li>● Support Investment Centre Director.</li> <li>● Serve as 'account executive' for high profile investment prospects and existing investors.</li> <li>● Draft position papers on investment climate and policy reform issues.</li> <li>● Maintain the CRM system and ensure its proper use.</li> <li>● Lead research activities.</li> </ul>	<ul style="list-style-type: none"> <li>● Master's degree in business, economics, management, or related discipline.</li> <li>● At least five years' experience in private business or state-owned enterprise, focusing on marketing, public relations, investor relations or similar areas.</li> <li>● Fluency in written and spoken English; other languages (Chinese, Arabic, Turkish, Korean, German, French) will be an asset.</li> <li>● Proven research and writing capabilities.</li> <li>● Knowledge of transport and logistics, energy, technology and/or manufacturing industries a plus.</li> <li>● Experience with customer relationship management (CRM) systems.</li> <li>● Web design, database management, or other IT experience a plus.</li> </ul>

Source: Investment Consulting Associates (2015), Available at <http://www.investinwarmiaandmazury.pl/Photos/Attachment/694ec403-2a87-4496-9c61-0ccff4e3934d-IPA-Best-Practices-Poland-Investment-Conference-2015.pdf>

digital customer relations system (CRM). As site visits have also become increasingly more challenging, some IPAs, especially in developed countries, have been deploying virtual reality investor site visits. Finally, COVID-19 has also highlighted the importance of maintaining an up-to-date, easy-to-navigate website for investors with the latest regulatory changes and COVID-related developments.

The total budget outlay for an IPA can range from US\$250,000 for a small IPA to US\$5 million for a fully-fledged autonomous organization with 20-30 or more staff able to compete internationally for investment and engage in all activities of 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 overheads and 2% capital expenditure. By activity, a typical breakdown is 30% for investment promotion, 25% for 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 defies the purpose of an investor-friendly IPA.

An important aspect of an IPA's internal management should 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.).

## E. Establishing an effective IPA – some key lessons

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, both in the public and private sectors. 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 an 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 US\$1 million and US\$5 million. In addition, an 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 an 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

The performance of IPAs needs to be closely monitored and evaluated against objectives and effectiveness of activities undertaken. Benchmarks can be used to compare an IPA's 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.

## 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 and 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 backed up by a specific law or part of a generic investment law?
6. Does your IPA combine other activities like export or outward FDI promotion?
7. What type of key performance indicators (KPIs) do you use to assess the performance of your IPA?
8. Do you have job descriptions for all major job profiles of your IPA?
9. Does your IPA have subsidiaries in the provinces/cities or do those localities have their own independent IPA? How are these IPAs coordinated? And if so, how do you coordinate activities?
10. 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 your IPA?
11. Does your IPA have a client charter? If so, is this helpful? If not, should you have one?
12. 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?
13. Does the IPA undertake a planning exercise of its activities to meet its stated goals and objectives? Does it undertake regular M&As of its activities, results and impacts? If so, how can it be improved?
14. 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?
15. What can be done to improve the overall performance of your IPA and what criteria do you use?





## CHAPTER



# Image building, investment promotion, and investor targeting

## A. Investment promotion strategies to attract foreign direct investment for sustainable development

### 1. The imperative of investment promotion

The competition among countries for attracting FDI is intense. Business and investment climate reforms to attract more FDI are often met by challenges such as information asymmetries. Countries thus “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. Therefore, it is necessary that IPAs offer high-quality and relevant services to foreign investors in different stages of their investment cycle (Heilbron and Aranda-Larrey, 2020).

This chapter focuses largely on the investment promotion activities of an IPA which can be a powerful means to attract FDI and maximize its benefits, in the context of a broadly sound investment climate. Investment promotion consists of leveraging the strong points of a country’s investment climate, highlighting profitable investment opportunities, and identifying local partners (OECD,

2020).<sup>1</sup> It consists of two primary activities – (a) image building and marketing, and (b) lead generation and targeting.

IPAs can provide a wealth of services classified as investment promotion, including the provision of market information to investors as well as the undertaking of feasibility studies and environmental impact assessments (UNCTAD, 2001). This Handbook

focuses in particular on the marketing activities that Governments and IPAs can undertake to promote locations/sites.<sup>2</sup> To actively promote a certain location or site an IPA must reach out to investors and convince them that investing there is worthwhile. Without such promotion efforts, the investment destination could be bypassed as a potential choice for the investor (see box 9.1).



### Pro-active investment promotion: Penang Development Corporation in Malaysia

In the early 1980s, pro-active investment promotion in Malaysia managed to attract international electronics investors to business-friendly export-processing zones around the international airport in the state of Penang to assemble low-end products and mass-produced printed circuit boards. Malaysian authorities wanted to induce international electronics investors to upgrade their operations to more complex sub-assemblies and final products, while assigning design functions into local plants.

Looking to move into more skill-intensive production of computer and data processing products, the Penang Development Corporation (PDC) supplemented its investment promotion responsibilities in 1989 with a complementary Penang Skills Development Corporation (PSDC). Under the auspice of a steering committee headed by Motorola, Hewlett-Packard and Intel, they persuaded 24 electronics investors to contribute equipment and assign executives to teach at the new PSDC campus; they led the group in assigning executives to teach the skills needed to design and produce sophisticated electronic subassemblies and final products. Within seven years, a study funded by the United States Agency for International Development (USAID) ranked PSDC as one of the 10 leading Workforce Development Institutions in the world. In terms of infrastructure upgrades, PSDC meanwhile added IT improvements to the industrial parks clustered around the international airport, and foreign investment zones in the State of Selangor and the Kulim Hi-Tech Park in the State of Kedah soon followed.

This decision has proved to be beneficial to Malaysia. With intensive lobbying, the Government of Malaysia began plans for the IT Multimedia Super Corridor, and in 2005 chose Penang to be the first in the country to be awarded Cyber-City status.

*Source:* Freund and Moran, 2017.

Results from a World Bank-WAIPA survey (2020) of IPAs illustrates that IPAs focused more on the provision of investment promotion services at the attraction stage vis-à-vis the entry and establishment stage. The most common services IPAs provide to investors are: business events and conferences abroad (or within the country) to promote priority sectors (93%) during the attraction stage; guidance on government structure, and regulatory and non-regulatory aspects for business start-up (77%) at the entry and establishment stage; communication with investors to gather information about grievances related to government conduct, and the provision of

tailored responses to questions asked by investors (65%) during the third stage, retention and expansion; and the facilitation and coordination of initiatives and events that provide networking opportunities in the local ecosystem (64%) at the forging linkages and spillovers stage, the last stage of the investment life cycle.

There are some countries that 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 as well as cheap and

<sup>1</sup> The OECD (2020) report is based on data from the OECD-IDB IPA database, which contains information on investment promotion agencies and practices from 69 economies in total, including 32 from the OECD, 10 from Eurasia, 19 from LAC and eight from MENA. The respondent countries in Eurasia include Afghanistan, Azerbaijan, Belarus, Georgia, Kazakhstan, Kyrgyzstan, Mongolia, Tajikistan, Ukraine and Uzbekistan. The report also draws on discussions held with IPAs in the framework of various workshops and missions.

<sup>2</sup> 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 and Wint, 2001).

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 and/or outstanding business climate and rule of law, clear comparative advantage, strategic location or other assets that attract foreign investors (e.g., the availability of a large market or natural resources) tend to have less need for investment promotion. Hence, FDI and development are mutually reinforcing. FDI can trigger development, while rapid development and associated market potential also attracts FDI (Hornberger and others, 2011; Iamsiraroj and Doucouliagos, 2015).

However, without the key determinants for FDI in place, investment promotion will have little effect. Nevertheless, 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 as well and Singapore, which have succeeded in attracting significant amounts of inward FDI. Obviously, these territories or countries also score very high in the quality of their business and investment climates.

## 2. The investment promotion strategy

As OECD (2015) has stated, the content of the investment promotion strategy should revolve around the question of “what to promote”, and depend 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 that goal (see chapter 8).

A successful investment promotion strategy consists of 10 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);
- KPIs 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 9.1 shows a basic investment promotion strategy action plan template. Activities need to be undertaken at the national and international levels.



**A basic investment promotion strategy action plan template**



Sources: ESCAP and International Consulting Associates.

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 that 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.

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 they find 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 and promotionally effective. For example, 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.

Research has shown 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. This can and should also be done in consultation with national sustainable development policy priorities.

## B. Investor perception and image building

### 1. Investor perception

More than 70% of all potential investors put together a shortlist of location options before the site selection professional is even contacted (VCC, 2009). This

shortlist is often based on personal perceptions of locations. Investors will typically shortlist locations where:

- They have current investment projects running;
- They are already operational;
- Their competitors have already invested;
- Major customers or suppliers are present;
- They rank well in location attractiveness rankings or competitive rankings;
- They have read positive reports about the location in the business press and media or through word of mouth;
- They have been on business trips or even on vacation;
- They have had a good experience in previously working with the IPA;
- They have family roots (diaspora investments).

Even when investors are aware of certain locations, their perceptions are rarely accurate. When Viet Nam began its policy of Doi Moi (economic liberalization) in 1986, FDI did not immediately pour in. The country had much work to do to convince investors it was no longer at war, despite the fact that the war had ended almost 10 years earlier. The negative perceptions of Viet Nam as a war country persisted well into the 1990s. Communication is therefore as strategic as the product or targeting itself. Selecting the right communication tools to send out the right messages at the right time (marketing mix) is an essential prerequisite before starting a promotion campaign. Negative bias caused or reinforced by mismanaged communication can be 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 or removal/correction of negative bias of investor perceptions (Fan, 2010; WAIPA, 2020).

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 are formed 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;

- Online searches via the Internet of the archives of leading newspapers, specialized reports/magazines/periodicals and online country reports;
- Surveys and questionnaires on the perceptions among existing and potential investors.

Information retrieved from the above on investor perceptions will tell the IPA what steps are required to bridge the gap between (a) how the target audience views a location and (b) 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 as well as determining the central marketing theme of an image-building campaign (World Bank, 2016). If investors have negative perceptions of some location factors that have recently improved, this information will help

local authorities to pinpoint a focus area for an image-building campaign.

These results can also indicate whether local governments should, in fact, 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 by the IPA is to bring these factors to the attention of the Government so that these obstacles can be eliminated. Where a country has a relatively stable and conducive investment climate, the results can pinpoint particular investor issues, of which the IPA was not aware. Box 9.2 shows the results of a survey done for Thailand's Board of Investment in 2020.



### Results of investor perception survey: Thailand

Thailand's Board of Investment (BOI) undertakes an annual "Foreign Investor Confidence in Thailand" survey, conducted by a private consultancy firm, Bolliger & Company Ltd. (Thailand). The results for 2020 were published in a report submitted in December of that year to BOI.

The survey found that for the 2020 edition, despite the COVID-19-induced economic hardship, 96% of the companies expressed confidence in the country's potential and have plans to continue their investment in Thailand, citing attractive investment incentives, a strong supporting industry supply chain and the availability of raw materials and parts as the reasons. To be more specific, out of the 600 companies surveyed, 76.67% intended to maintain their current investment level while 19.33% intended to expand their investment level.

The largest positive responses cited investment privileges granted by Thailand (89 respondents), the availability of sufficient raw materials and parts (77 respondents), and sufficient supporting industries (77 respondents) as the main reason for maintained investment. More than 60% of the surveyed investors said COVID-19 had an impact on their businesses, but they were still able to operate, while 29% were greatly affected but still able to operate and 7.5% were unaffected and able to operate as usual. Only 0.17% had ceased operations.

Source: Bolliger & Company (Thailand) Ltd., 2020, *2020 Foreign Investor Confidence Survey*. Available at [https://www.boi.go.th/un/boi\\_event\\_detail?module=news&topic\\_id=127237](https://www.boi.go.th/un/boi_event_detail?module=news&topic_id=127237)

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 until there is evidence the situation is improving or has improved. An image-building campaign can run for several years and should thus be incorporated into the IPA's multi-year budget (World Bank, 2016).

## 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 important 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 country's brand image and conduct a professional benchmarking with competitor locations in order for each target sector/activity to develop compelling sales messages as well as proposition-based marketing materials and tools (UNCTAD, 2008).

Image building is particularly important for countries that 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 at themselves or at neighbouring countries). It is equally important for small countries that receive little international media coverage. Image building may require considerable and well-targeted expenditure over time, but is itself not sufficient for a location decision (Asfour and Declan, 2005). At the image-building stage, the basic tools of marketing are applied to promote the country/area usually to the general investor but also to 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*

Eight simplified steps are offered here to assist IPAs in preparing an image-building strategy if they are unsure of how to go about it.

**Step 1:** Prepare for successful image building by ensuring that 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) or Value Proposition (VP): a statement that contains a characteristic that sets the location to be promoted apart from the competition as an investment location. Box 9.3 provides examples of USPs and VPs.

The USP is often developed on the basis of a SWOT analysis, and should be accurate and truthful. The USP should make investors confident about the location's superior attractions (World Bank/MIGA, 2000b). 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 equally comparative advantages.

**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 goals/objectives with low priorities. Set the targets, including interim targets with clear time frames, in relation to each goal/objective in order to 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: marketing theme; targeting messages and promotion materials at investors; continually developing and updating public relations materials; using a broad spectrum of media to convey the message; building and developing media contacts; working to position the local IPA as the best source of information (credibility building) for the media on investment-related issues; and working 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 that there are no conflicting commitments or overlapping programmes and activities, and that there is adequate time to execute the campaign.

**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



### 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; while some IPAs use catchy general phrases, they rarely explain why something is unique enough to the location to be promoted.

Sri Lanka has a website presenting its USP in terms of an overview of the country's advantages and attractions (see <https://investsrilanka.com/#srilanka>). However, while such an overview is important and a 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 Fiji, Investment Fiji, has a USP that, although perhaps long, at least immediately shows the country's marketed advantage as an exotic investment location – "TRADE and INVEST where paradise is yours, and where the world you left behind is only a mouse-click away!" (See <http://www.investmentfiji.org.fj/>).

The Malaysian Investment Development Authority (MIDA) has the following USP – "Invest in Malaysia: Your Profit Centre in Asia" (see <http://www.mida.gov.my/home>). The USP is good as it informs investors of potential profit opportunities without claiming the country is the best profit centre. In this regard, it is at least truthful and not overambitious.

The Republic of Korea uses the following slogan – "Invest in Korea, Where Success Knows No Limits" (see <https://www.investkorea.org/ik-en/index.do>). While it is a nice slogan, it does not show a real competitive advantage of the Republic of Korea as an investment location and may not appeal to investors who may wonder what "Success" with "No Limits" is all about.

*Source:* Websites mentioned in text.

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 to image building, the requirements should be estimated carefully, e.g., in terms of:
  - (a) How many people are needed – what will each person do?
  - (b) What type of skills and at what level do these tasks require?

- (c) What facilities, materials etc. are required for each activity?
- (d) What IT support is needed?
- (e) What overall costs are involved – can the estimates be justified?
- (f) If outside resources are needed, can these be purchased or contracted?

#### (c) *Image building tools*

Image-building tools include:

- News releases; features and articles or newsletters. Such releases and articles are important, especially when placed in well-established newspapers or business journals. In addition, in order for such a release to be effective, it should be placed repeatedly, containing a persistent message. Given data protection rules, the use of newsletters and releases is more limited for IPAs;

- Introductory brochures. Well-designed, brief to the point information, accurate and truthful; a summary of expected services for investors. The brochure should convincingly answer the question of why should an investor invest in this location?
- Investor guide. An investor guide provides an overview of the country as a prime investment location, featuring the overall business climate, investment opportunities, data on trade and FDI, and useful contacts. The investor guide should be easily accessible on the IPA's website;
- Sector profiles. They provide detailed information on the key target sectors of an IPA. Information is focused on relevant information for investors in target areas, such as human capital, labour costs and quality, infrastructure cost and quality, rent, land availability and real estate costs;
- 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;
- Infographic. An infographic shows the country's competitive strength, using eye-catching graphic designs and visuals that are easy to read and digest by investors;
- Website. Brochures and fact sheets can be published on the IPA's website. The website is essential for any IPA and must be a repository for all relevant information for investors and include all the items listed in this overview (see below on the role of websites and social media in investment promotion);
- Social media channels. LinkedIn, Facebook, Instagram, Twitter and YouTube are all social media channels that can be used by IPAs to communicate with investors;
- Promotional video. Relatively expensive and will be outdated quickly. Videos should be brief, to the point and focused. They should be interesting to watch and not have any lengthy statements by politicians about how wonderful the country is;
- Podcast. A podcast is a more cost-friendly approach to communicate with a USP or VP of a country, or it can be industry focused. Podcasts are relatively informative and not too long. However, they take time to develop;
- 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 an international reputation. A specialized advertising/public relations firm can be recruited for this purpose if the IPA's budget allows for it;

- Infomercials for television. Such campaigns can be effective if repeatedly shown. However, they are very costly in terms of development and placement, but they give the IPA total control of what should be contained in the infomercial;
- Promotional conferences, fairs, seminars and roadshows. These are aimed at a targeted audience and should therefore be well-prepared with high-quality speakers, including established investors who can act as an 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 the launch of an image-building campaign and are probably better as an investment promotion tool than as an image-building tool.

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 that the investor cannot do without. Such a package should contain, at a minimum:

- An 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;
- The latest issues of newsletters (if any).

An investment opportunity profile should contain the characteristics of a given sector that is 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 the location and the sector. Some good examples can be found on the following IPA websites:

- Invest Korea on ICT sector: [https://www.investkorea.org/file/ik-en/ICT\\_2020\\_eng.pdf](https://www.investkorea.org/file/ik-en/ICT_2020_eng.pdf);



- Thailand BOI aerospace sector: [https://www.boi.go.th/upload/content/BOI\\_brochure\\_aerospace.pdf](https://www.boi.go.th/upload/content/BOI_brochure_aerospace.pdf);
- MIDA Malaysia and the service sector: <https://www.mida.gov.my/publications/malaysia-investment-in-the-services-sector/>.

### C. The location selection process of companies explained

#### 1. International site selection

In order to develop a meaningful positive image and investment promotion strategy, IPAs need to have a realistic understanding of the competitive position of the promoted location. This involves a comprehensive benchmarking exercise which should result in a solid location value proposition (LVP). IPAs need to know the factors and considerations investors use in selecting their sites for investment in order to develop

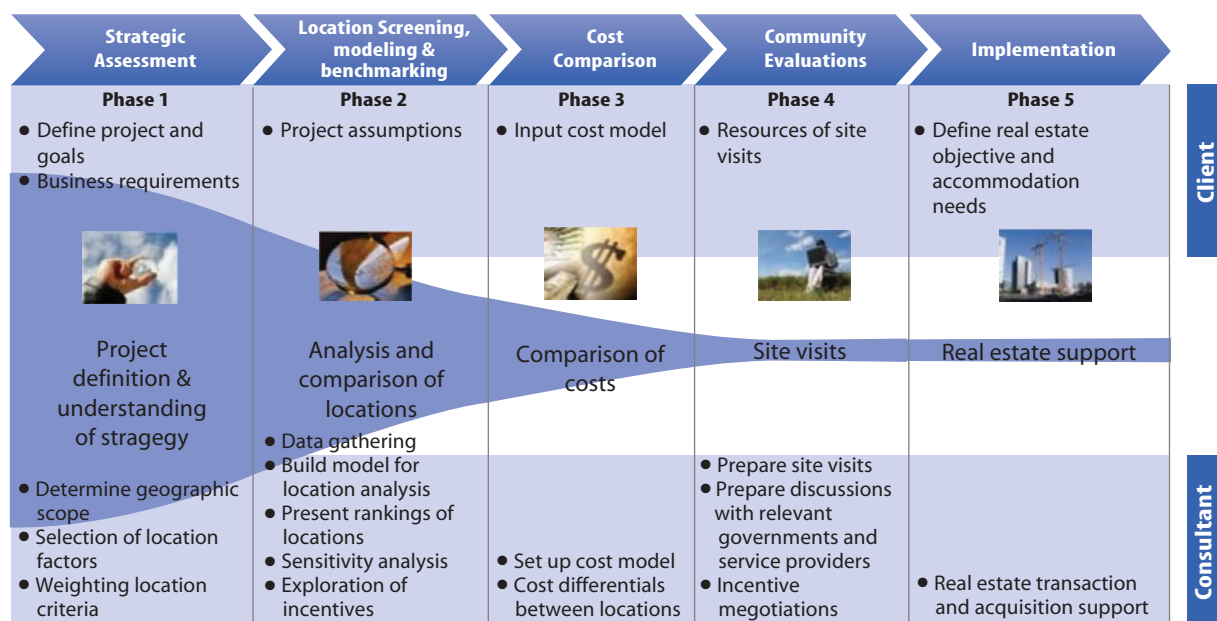
a meaningful LVP. In other words, knowing investor needs and requirements is fundamental to presenting an attractive LPV that can convince investors that the promoted location/site is the best option available.

Corporate investors (or rather the professional location advisers and site selection consultancies) use models to evaluate location competitiveness and calculate the return on investment, according to which investment decisions are made. Many firms today outsource the location selection process to specialized consultants.

More specifically, five phases of a typical corporate site selection process are identified in figure 9.2. These five phases can also be used by IPAs to mirror the corporate site selection decision-making process for their own benchmarking exercise, and to anticipate investor needs. Each phase is discussed in detail below.



The investor location decision-making framework\*



Source: van den Berghe, 2018.

\* The site selection process is increasingly being outsourced by investors to professional location advisers and site selection consultancy companies.

##### (a) Phase 1: Strategic assessment

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 (phase 3) in the host country. Capability factors can be divided into two categories – natural endowments and developed resources (table 9.1).



**Table 9.1**  
**Capability factors divided into natural endowments and developed resources**

Natural endowments	Developed resources
Access to abundant water supplies	Airports and seaports
Climate	Cities
Raw materials and minerals	Human resources
Sea access	Universities – education
Bordering neighbouring countries	Roads
Population	Telecom infrastructure
Cities	Industrial sites and free zones
Ancient cultural treasures	Legal framework
	Market opportunities

Source: Investment Consulting Associate.

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 the location criteria, some are specific to industry groups (i.e., automotive, services and manufacturing), whereas some relate to geography and/or the timing of the project. There are also decisive criteria associated with either the company policy or personality factors. Thus, a company's strategies determine locational decisions – understanding the decision-making process within the company is of significant value;
- What are the main requirements of the investment project? The answer is associated with evaluating and calculating all factors that might affect the locational decision. This information is often obtained through questionnaires with regard to objectives, (current) sites and buildings, financial assumptions, value chain, (human) resources, utilities and ecology (i.e., serve as input for phase 3).

One way of looking at the motivation factors is to distinguish two sets of determinants – first, firm or industry-specific determinants which inform the initial decision to invest abroad, and second, the host country – or location-specific determinants which influence the decision on the final investment destination. The importance of these two groups of factors varies strongly with company size, market orientation (domestic versus export), industry subsector and investor nationality. IPAs need to understand the firm-specific determinants that can

influence location-specific determinants in order to meet investor needs.

(b) *Phase 2: Location screening, modelling and benchmarking*

For the investor, locations are identified and compared on the basis of various criteria, including those used for the strategic assessment. 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 second, 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:

- Analysis of local, regional and global FDI trends; and
- Conducting a location benchmark analysis based on a defined list of location criteria.

Conducting research on FDI trends with regard to destination, sources and sectors enables IPAs to position the competitiveness of the host country in the global FDI arena. This analysis indicates whether sector- and business-specific activity matches current investment trends, and shows 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 meet, or may even improve, the competitiveness of the host country.

For different geographical levels (for example, world, Asia, South-East Asia, country, province, city or EPZ) an 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 inward FDI hotspots?
- Sector and subsector FDI assessment – what sectors and subsectors is the FDI is coming into?
- Business activity FDI assessment – what type of business activity does the FDI target?
- Identify key motives and location determinants for a particular investment.

With regard 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 for

doing so. The three most commonly used methods are:

- Benchmark module – evaluate, benchmark and rank the competitiveness of countries and cities by selecting a wide variety of location factors;
- 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/cities in line with their cost-benefit capabilities in order to further identify and verify the overall investment climate.

Before conducting the benchmarking analysis, appropriate data should be verified and cross-checked. Moreover, locational factors should be weighted. The weighting process should reflect reality as much as possible. For example, 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 than the investor to benchmark the location as it has access to primary and up-to-date data that are not readily available to the investor. The role of the IPA is to bring the location to the attention of the investor, gain the investor's interest and then work with the investor to provide the information needed to market the location.

#### (c) Phase 3: Cost comparisons

For the investor, activities within this phase include the development of cost models and the 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 an 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 and reliability of utilities and their supply (gas and electricity);
- Water and sanitation;
- Oil-related products;

- Information and communication technology (ICT);
- Taxes;
- Transportation costs and quality of service by logistic service providers;
- International flight costs and reliability of airlines (e.g., delays);
- Security costs and quality of security firms (e.g., references by 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 and loss expenses, and total net income (figure 9.3). An additional assessment includes the financial impacts of different incentive packages offered by different locations. 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 may have to request this data from 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 is further discussed in the next chapter.

#### (e) Phase 5: Real estate strategy and final site selection

Finally, in phase 5, real estate and land requirements are highlighted and compared for the different site



Financial feasibility analysis of various investment locations

	A	B	C	D	E	F	G	H	I
1	<b>Financial Summary &amp; Assumptions</b>								
2									
3									
4	(All Amounts in €000's)								
5	Country								
6	<b>Metric</b>	<b>Location A</b>	<b>Location B</b>	<b>Location C</b>	<b>Location D</b>	<b>Location E</b>	<b>Location F</b>		
7	Net Present Value	2,933	2,920	2,920	2,964	2,965	2,895		
8	Rank	3	4	5	2	1	6		
9									
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		
12									
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		
15									
16	Total Net Income	853	849	849	861	861	843		
17	Rank	3	4	5	2	1	6		
18									
	A	B	C	D	E	F	G		
2									
3									
4	(All Amounts in € 000's)								
5	Country								
6	<b>Region</b>	<b>Location A</b>	<b>Location B</b>	<b>Location C</b>	<b>Location D</b>	<b>Location E</b>	<b>Location F</b>		
7									
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 Transportation	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	<b>Total Cost of Sales</b>	<b>22,442,044</b>	<b>22,352,378</b>	<b>22,350,245</b>	<b>22,651,412</b>	<b>22,655,778</b>	<b>22,179,330</b>		
18									
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	<b>Net Income</b>	<b>852,798</b>	<b>849,390</b>	<b>849,309</b>	<b>860,754</b>	<b>860,920</b>	<b>842,815</b>		
22									
23	<b>Total Expenses (Incl. Taxes)</b>	<b>22,711,348</b>	<b>22,620,606</b>	<b>22,618,447</b>	<b>22,923,229</b>	<b>22,927,648</b>	<b>22,445,482</b>		

Source: Investment Consulting Associates.

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;
- Important inputs from subject matter experts (e.g., plant directors, real estate brokers, ICT experts, human resources, legal etc.);
- Real estate plan;
- Final recommendations of the most favourable site.

Table 9.2 provides two cases of the decision by an investor engaged in 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).



**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)	<ul style="list-style-type: none"> <li>Local market presence;</li> <li>Cost structure;</li> <li>Local incentive schemes;</li> <li>Connections to local organizations;</li> <li>Access to university clusters/research communities.</li> </ul>	<ul style="list-style-type: none"> <li>Presence in important market areas;</li> <li>Presence near the customers;</li> <li>Presence in important technology areas;</li> <li>Business friendly administration and low red-tape level.</li> </ul>
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 revenue.	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).

Due to the COVID-19 pandemic, the number of main attractions of investment locations and sites in the future will change, and this will have an impact on promoting these sites. Some of these changes are mentioned below (EGM, 2020; Loewendahl and van den Berghe, 2020):

- Virtual work (including working from home) to varying degrees, depending on the sector and country, is here to stay;
- A well-developed, high quality and reliable digital infrastructure;
- The location of FDI will be driven by talent pools and quality-of-life factors more than ever before, especially in the digital economy or for sectors that are more profound within Industry 4.0;
- Second- and third-tier cities, and rural and semi-rural areas have more potential to attract FDI – this may mean a much smaller office (and the main office maybe in a different/bigger city) and staff working from home, only visiting the office when needed;
- Office requirements will change based on blended solutions of virtual and office working. IPAs must anticipate this when promoting sites;
- Office requirements for all industries will be much more focused on sustainability issues (e.g., green office buildings);
- Talent attraction is going to become more important and competitive. New incentive packages to promote talent attraction, packaged services and support for investors as well as individuals to locate in their region are likely to become more important.

Other than these changes, the main site selection factors are likely to remain the same as before, and emerging trends are likely to continue.

## 2. Benchmarking for the investment promotion agency: A closer look

The process for site selection as described above is also followed by IPAs, which already engage in benchmarking their location when they develop the USP. For IPAs, the strategic assessment normally involves a SWOT analysis of a location (box 9.4) 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. Benchmarking is the process of comparing one's business climate and performance metrics with 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?
- How sustainable are we compared to others?

Thus, benchmarking is important for:

- Gaining an understanding of the complexity of investment location decisions by potential investors;
- Providing an objective and realistic “picture” of the host location compared to competing alternative locations in the region;
- Assisting the potential investor in making a fact-based investment decision;
- Presenting the IPA as a knowledgeable and professional organization;
- Continuously provide insight, monitor the USPs and mitigate weaknesses of the location.

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 fact. On the whole, benchmarking could prove to be a useful tool for IPAs and policy-makers, as it reveals complexities and gaps in their investment climate as well as depth and sophistication of the site-selection process of corporate investors.

IPAs need to undertake various steps for an effective benchmarking exercise on investor needs:

- Identify the investment facts and figures of potential investors such as:
  - (a) How many jobs will the project need?
  - (b) What type of jobs?
  - (c) How much land or office space does the potential investor need?
  - (d) Volume of utility usage;
  - (e) Transportation/containers.



### SWOT analysis for location benchmarking

A SWOT analysis is important when assessing 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 example:

**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: (a) available labour; (b) proximity to infrastructure (Special Economic Zones or SEZs), natural resources and/or nearby markets; (c) telecommunications; (d) recreation; and (e) framework to facilitate and incentivize sustainable investment. 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 points 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 key trends and developments are emerging that are positive (opportunities) or negative (threats) to attracting investment to a certain location (opportunities). Opportunities and threats may affect a location's current strengths and weaknesses, which are not static but will change over time. Opportunities and threats, like strengths and weaknesses, are very location-specific. However, typical trends and developments that translate into opportunities may be: (a) recent liberalization initiatives in a particular sector; (b) the conclusion of a bilateral or regional investment agreement or regional trade agreement; (c) discovery of new deposits of natural resources; (d) construction of a state-of-the-art SEZ; (e) pending privatization initiatives; (f) the introduction of new incentives; (g) sustainable and responsible investing initiatives; or (h) a company's ability to manage its ESG risks and opportunities 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: (a) environmental degradation undermining the sustainability of an investment; (b) labour unrest and strikes; (c) incidence of a natural disaster (earthquake, cyclone, flooding and drought etc.); (d) change in government with different ideas about FDI; (e) expiration of favourable trade privileges; (f) changes in multilateral trade agreements; (g) electricity outages due to insufficient utilities infrastructure, among others.

Strengths, weaknesses and, in particular, opportunities and threats need to be identified by the IPA in close consultation with the stakeholders, including domestic and foreign investors, key government ministries and agencies, and civil society through roundtables 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 a given site/location as a potential investment destination for a particular investment in a particular specified sector.

Source: World Bank/MIGA, 2000a.

- Identify a list of competing candidate countries and/or regions for specific potential investment projects in your region.
  - (a) Critical: low labour costs;
  - (b) Critical: utility costs;
  - (c) Important: availability of skilled labour;
  - (d) Important: accessibility.
- Identify relevant location factors for the investment projects such as:
  - (a) Labour costs;
  - (b) Taxation;
  - (c) Access to public transport.
- Identify which location factors are critical and which are important to the success of the investment projects such as:
  - (a) Critical: low labour costs;
  - (b) Critical: utility costs;
  - (c) Important: availability of skilled labour;
  - (d) 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.

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: (a) factual reports by commercial entities; (b) statistics bureau, Eurostat, United States Census, and national and regional bureaus; (c) international organizations (UNCTAD, the World Bank and OECD; (d) free zones and industrial parks – survey data on cost items; (e) specialized media and online groups – EIU, FDI executive, Creopoint etc.; and (f) 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. Also consider chapter 4-B-2 and table 3.4. In addition, IPAs can start to build up their own databases with macro-level indicators that measure the business environment of a country, and work together with subnational IPAs to cover the subnational level as well (i.e., rental costs, labour costs, land etc.).

### 3. Preparing and presenting the Location Value Proposition

#### (a) Preparing the LVP

Benchmarking provides the basis for the preparation of powerful LVPs that 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 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, as they contain more comprehensive information. Investment locations that are offering unique capabilities and reasonable cost levels generally rank high in benchmark exercises.

LVPs do not only show statistics, they also help in drawing powerful conclusions that will result in an appealing value proposition. Keep the value proposition short and simple, and develop one for each of the priority sectors. Use qualified sources only (e.g., direct quotes, up-to-date prices).

The example shown in box 9.5 illustrates the fact that business factors, including the actual numbers, increase the credibility of the value proposition.

#### (b) Presenting the LVP

In order to effectively promote a location, senior IPA officers must have good presentation skills. This includes delivery as well as preparations.



#### An example of a value proposition in the IT and ITeS sector – Bangladesh

1. Large domestic and regional market opportunity
  - Increasing demand and adoption of technology across banking, telecom, and manufacturing industries.
  - Large-scale e-government projects in the pipeline.
2. Attractive business environment
  - Highly-attractive incentives facilitating the investment process.
  - Focused government investments to boost quality and availability of both physical and IT infrastructure.
3. Large, young, trainable talent pool
  - One of the youngest demographics with 50% of the population below the age of 25.
  - Large entry-level pool with 543,000 annual tertiary graduates, supplemented by a larger freelancer community.
  - Government initiatives targeting the training of 65,000 IT-ITeS- related professionals by 2018.
4. Lowest cost of operations globally
  - Lowest operating costs among the top 250 IT-ITeS delivery locations, with 20-30% savings over India and the Philippines.
  - Cost proposition enhanced by lucrative government incentives.

Source: Everest Group. Available at <https://www.everestgrp.com/2018-03-bangladesh-ites-value-proposition-market-insights-43855.html>



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. Presentation should be tailored to match the interests of the audience, and should 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; nonetheless, the IPA should try to target the audience it expects to address as much as possible. The presentation should have a clear purpose, conveying key points accordingly. Remember, you never get a second chance to make a first impression. Table 9.3 outlines what should be in the LVP power point presentation.



**Table 9.3** Typical outline of a location value presentation

Main theme	Topics
<b>1. Title slide</b>	Begin with your (image building) theme that outlines the value proposition or specific business opportunity for investors.
<b>2. Key description and benefits of the location, including cost advantages</b>	Highlight the key capabilities, sustainability and cost advantages or distinctive strengths of your country/location, specific to the sector, including the quality of life (schools and entertainment etc.), and to what extent sustainability is taken into account. 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.
<b>3. Factual evidence</b>	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.
<b>4. Present key laws and regulations affecting the possible investment</b>	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.
<b>5. Support services – including incentive support</b>	Provide short information about the services that the national/local IPA can provide, including available incentives, one-stop shop services and aftercare.
<b>6. Testimonials/case studies</b>	Include investor testimonials or case studies of successful investments in the specific sector/location.
<b>7. Top 10 reasons why</b>	Repeat your message to conclude the sales presentation by summarizing the top 10 reasons for investing.

Source: Investment Consulting Associates, 2012, *IPA Handbook*.

A common mistake made in presentations is the inclusion of numerous statistics. Reciting a series of statistics is quite boring for an audience, who will not remember all the details even if they are listening carefully. Often, the fonts of statistics in large tables are too small to be clearly visible for a larger audience. Hence, only use selective statistics in line with the purpose and summarize the trends. Make sure that the presented information is accurate and up-to-date.

Key best practices in delivering the presentation include:

- Rehearsing and reviewing the presentation beforehand. If more than one investment officer from the IPA is presenting, they should both 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 with the investor's critical needs;
- 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, it should be noted and the investor told

that somebody will get back to them. Then get back to them with the answer as soon as possible;

- Investors are primarily interested in factors affecting their profits, costs and, for many forms of investment, in the quality and availability of labour. 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, the IPA could inquire about a site visit.

IPAs, like the companies they seek to attract, increasingly use professional agencies to undertake benchmarking and preparation of LVPs. One source from which to find all FDI-related professional advice is [www.wavteq.com/systems/wavteq-influencers](http://www.wavteq.com/systems/wavteq-influencers), a database developed by WAVTEQ. This database 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 it to the right people in key organizations and companies.

## D. Investment promotion tools: Websites and social media

The COVID-19 pandemic has rendered the use of websites and social media by IPAs more important than ever. The digital economy has created powerful new tools that can be harnessed innovatively to promote and facilitate investments across sectors. The need for such tools will continue to grow, as investors will judge the suitability of an investment location from the level of digital connectedness and competence of their first point of contact – its IPA.

Today, IPAs are using two main types of digital economy applications to promote and facilitate investments – websites and social media.

### (a) Websites

Websites were IPAs' first digital tool, with developed country pioneers setting up their portals about 20 years ago. Typically, these early websites presented static narratives about the key features of the host location, accompanied by maps, local economic and demographic data and, sometimes, photographs. They also listed and described the IPA's services, relevant FDI and sector regulation, and star foreign direct investors and their projects.

Today's best practice websites are far from static. They employ a variety of interactive content, often in multimedia format. Common elements include welcome videos from host country officials and testimonials from satisfied investors. Some have investors sharing their local success stories and observations. Websites increasingly serve as matchmaking platforms, presenting listings of local businesses in a particular sector or location. They can contain interactive maps, economic data reports and newsletters, podcasts, photo galleries and blogs. However, many developing country IPA websites remain poorly developed and designed, do not have a good navigation structure, provide poor information and often are not well-accessible.

### (b) Social media

IPAs now employ social media for various purposes. A total of 91 IPAs responding to a World Bank-WAIPA (2020) survey said they relied heavily on LinkedIn to identify investors, gather investor intelligence, engage with investment promotion consultants, and identify and recruit staff (table 9.3). They used a mix of social media to research and engage with other IPAs and competing investment locations.

### (c) Additional tools

Increasingly, and especially due to the COVID-19 travel-related restrictions, more advanced websites now also enable virtual tours of cities and potential project sites. In addition, IPAs have started to use virtual meetings, virtual site visits and virtual matchmaking sessions to engage with potential investors. These additional digital tools are addressed in the final section of this chapter.

## 1. Developing and enhancing a website

There are at least three major advantages of using the website for investment promotion – it can be accessed by anyone with an Internet connection, virtually all promotional material can be published there, and it is very cost-effective compared to reproducing hard copies of all the 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; Hong Kong, China; Spain; and Singapore which provide good examples of attractive websites (table 9.4 and figures 9.4, 9.5 and 9.6).

**Table 9.4**

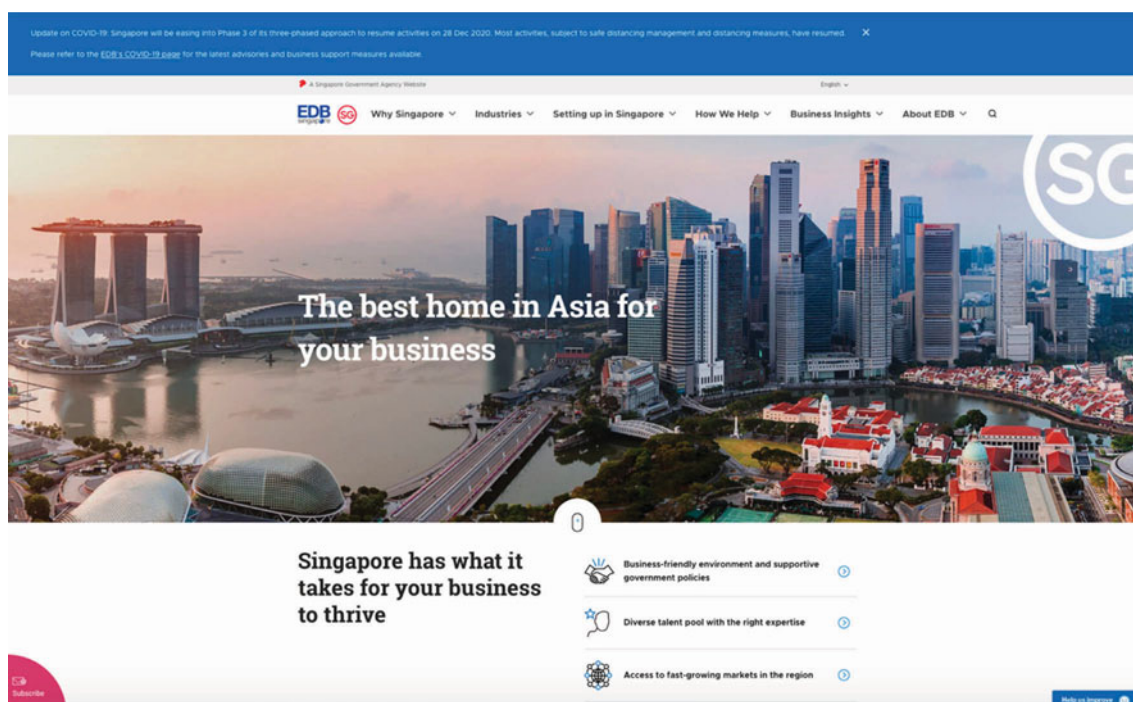
**Top best practice IPA websites**

Easter Europe, Western Europe and Central Asia	Middle East and Africa	Central America, the Caribbean and South America	Asia-Pacific
<p><b>Netherlands:</b> Netherlands Foreign Investment Agency (www.investinholland.cpm)</p> <p><b>Ireland:</b> IDA Ireland (www.idaireland.com)</p> <p><b>Germany:</b> Germany Trade and Invest (www.gtai.de)</p> <p><b>Hungary:</b> Hungarian Investment and Trade Development Agency (www.hipa.hu)</p> <p><b>Sweden:</b> Business Sweden (www.business-sweden.com)</p>	<p><b>Morocco:</b> Invest in Morocco (www.invest.gov.ma)</p> <p><b>Israel:</b> Invest in Israel (www.investinisrael.gov.il)</p> <p><b>Bahrain:</b> Bahrain Economic Development Board (www.bahrainedb.com)</p> <p><b>Saudi Arabia:</b> Invest Saudi (www.investsaudia.sa)</p>	<p><b>Costa Rica:</b> Costa Rican Investment Promotion Agency (www.cinde.org)</p> <p><b>Colombia:</b> Procolombia (www.procolombia.co)</p> <p><b>Chile:</b> Invest Chile (www.investchile.gob.cl)</p> <p><b>Nicaragua:</b> PRONicaragua (www.pronicaragua.org)</p>	<p><b>Hong Kong, China:</b> InvestHK (www.investhk.gov.hk)</p> <p><b>Singapore:</b> Singapore Economic Development Board (www.sedb.com)</p> <p><b>Republic of Korea:</b> Invest Korea (www.investkorea.org)</p> <p><b>Australia:</b> Australian Trade and Investment Commission (www.austrade.gov.au)</p>

Sources: Conway. Inc, Top Investment Promotion Agencies, 2020). Available at <https://siterelection.com/issues/2020/may/top-investment-promotion-agencies-2020.cfm>. OCO, Investment Promotion Agencies Benchmarking Study, 2018. Available at <https://www.ocoglobal.com/wp-content/uploads/2019/02/OCO-IPA-Benchmarking-Study.pdf>. Loewendahl, 2018. Available at <https://publications.iadb.org/publications/english/document/Innovations-in-Foreign-Direct-Investment-Attraction.pdf>

**Figure 9.4**

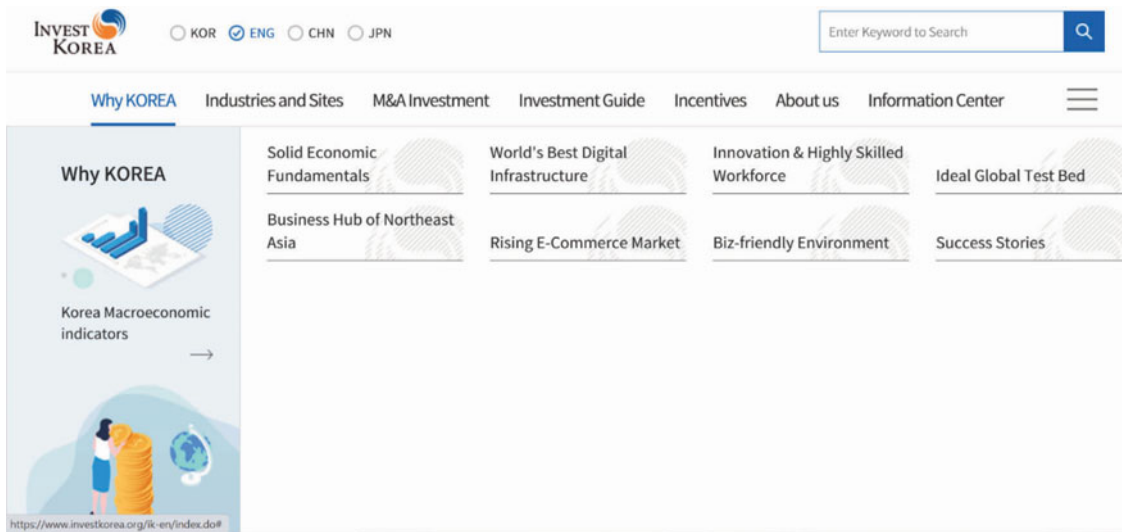
**Regional best practice – website of the Economic Development Board, Singapore**



Source: Available at [www.edb.gov.sg](http://www.edb.gov.sg)

Figure 9.5

Regional best practice – website of Invest Korea



Source: <https://www.investkorea.org/ik-en/index.do>

Figure 9.6

Global best practice website of the Netherlands Foreign Investment Agency



Source: [www.investinholland.com](http://www.investinholland.com)

The website should be tested offline a few times to make sure everything functions properly before it is launched. Following the launch, IPAs should remember that maintaining a website is an ongoing process. This includes updating information, posting new materials and information, and regular testing of the website. If maintenance fails, the website will quickly become outdated and eventually turn into negative 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 it is included in their retrievals when users conduct Internet searches. This is referred to as Search Engine Optimization (SEO). An 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, such as chambers of commerce, government ministries and agencies, and the host country's embassies and consulates, among others. National IPAs commonly have links with subnational (provincial/municipal) IPAs and vice versa.

While a website is not only important for information provision and image building, it is also a primary tool for generating investment leads and increasing FDI projects in the host country. Thus, the website should contain some form of customer relationship management (CRM) system to capture investors interested in learning more about the host country or investment location.

Table 9.5 identifies 10 components of a world class website that IPAs should refer to when developing and maintaining their own website (World Bank Group, 2012; van den Berghe 2018).

An effective IPA website contains the below sections and content:

- About us. Information about the IPA – a brief history, mission and vision statements, objectives, management team (with brief, focused bios), structure and organizational diagram and; annual reports. Contact persons, including their detailed contact details – (cell) phone numbers, emails

and LinkedIn connection. Make sure the IPA website is personal and a potential investor feels 'at home'.

- Services. Information on investment facilitation services, including site visits and aftercare services with contact details of relevant officials, business registration procedures and forms, and one-stop shop services for other permits and licences.
- Information on general business and investment climate. This section should also contain subsections with the following information:
  - National economy overview;
  - Regional economy overview;
  - Benchmarks and ranking of the country;
  - Investor guide;
  - 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);
  - Overview of costs of doing business – utilities, labour, land rents, working capital and transportation;
  - Quality of life;
  - Useful links and contacts.
- Investment opportunities in the host country. This section can reference both projects as well as sectors.
- Press. This section should contain up-to-date, relevant news and publications related to FDI and the IPA's work.
- Inquiry (e-mail inquiry form and telephone/fax contact points). Make sure the phone numbers include country codes. Most investors prefer to not fill in any form, but have the general contact information (i.e., info@...) if the name of a contact person can be provided. This is much better and personal (for example, a project manager for specific sectors).
- Contact us. Include social media links.

Advanced IPA website features may also include a searchable, interactive "Investment Map" using the Geographic Information Service (GIS)<sup>3</sup> mapping (see box 9.6), or COVID-related information (see box 9.7).

<sup>3</sup> For more information see <https://www.gisplanning.com/products/zoomprospector/lead-gen-id>, <https://www.gisplanning.com/products/zoomprospector/overview>



**Ten components of a world-class website**

Component	Methods
Authenticity of place branding and messaging	<ul style="list-style-type: none"> <li>Communicating a true and unique positioning of the region (USP)</li> <li>Utilizing recognizable national elements.</li> <li>Capturing users' attention to inspire them to use the site.</li> </ul>
Clarity and ease of navigation	<ul style="list-style-type: none"> <li>Use a simple top bar and/or simple side menus.</li> <li>A prospect-specific section placed prominently.</li> <li>Straightforward navigation.</li> <li>Providing the top 10 most requested pages.</li> <li>Keeping all valuable content three clicks or less from the homepage.</li> </ul>
User-friendly	<ul style="list-style-type: none"> <li>Ease of reading, using medium-sized font (Verdana or Arial),</li> <li>Appropriate use of graphics.</li> <li>Easy downloads of PDF documents.</li> </ul>
Depth and quality of content	<ul style="list-style-type: none"> <li>Using a content management system that enables publishing of pages, downloadable documents and data.</li> <li>Weekly updates on news items and events.</li> <li>Offering video content.</li> <li>Direct – one click – access to investment guides.</li> <li>Accurate information with references.</li> <li>Provide only relevant information.</li> <li>User segmentation: mainly for foreign and domestic investors.</li> </ul>
Use of search marketing approaches	<ul style="list-style-type: none"> <li>Search engines connect those who are already looking to you.</li> <li>Clicks can be free (large list in main column), but ranking is harder to receive.</li> <li>Clicks can also be paid (ads at right) and be at the top of the list on the same day.</li> <li>Ensure that searching your location or IPA name results in being on top of the list.</li> <li>Utilizing paid search (pay-per-click or PPC) services to increase traffic on the website.</li> </ul>
Effective use of email marketing and news sections	<ul style="list-style-type: none"> <li>Monthly email newsletter to investors, prospects.</li> <li>Tracking performance of those newsletters.</li> <li>Posting newsletters and news items to the IPA website weekly or monthly.</li> <li>Stay up-to-date. If not, "news" is counterproductive.</li> </ul>
Frequent and effective performance tracking	<ul style="list-style-type: none"> <li>Receiving a performance report (on the region and the IPA) once per month.</li> <li>Not using "hits" (i.e., Number of searches by search engine for the website) – bad indicator.</li> <li>Tracking unique investor visits (resulting in follow-up), web references (by search engine) and number of downloads.</li> <li>Integrated tracking of advertising, web and PR effectiveness.</li> <li>Use Google Analytics for track and trace.</li> </ul>
Use of maps and Geographic Information System (GIS) technology is essential for site evaluation and selection purposes	<ul style="list-style-type: none"> <li>Integrated with IPA website.</li> <li>Using maps with various layers (transportation, education etc.).</li> <li>Using integrated real estate searches/GIS mapping software.</li> <li>Generating dynamic demographic and business reports.</li> </ul>
Use of new and social media	<ul style="list-style-type: none"> <li>A website should have effective linkages with social media.</li> <li>Providing links between IPA website and its LinkedIn and Facebook profiles.</li> <li>Keeping an active Twitter account.</li> <li>Having a blog and updating it four times per month.</li> <li>Incorporating "share" features on your site.</li> </ul>



### 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. Very helpful in this respect is the provision of geographical information systems (GIS) on 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;
- Can be used to identify which companies are researching your location.

The next generation GIS are 3D and satellite-based, which allow investors virtual familiarization tours of a certain location. Examples are the IPAs of Murcia (Spain) and many Economic Development Organization (EDO) websites in North America like Jobs Ohio.

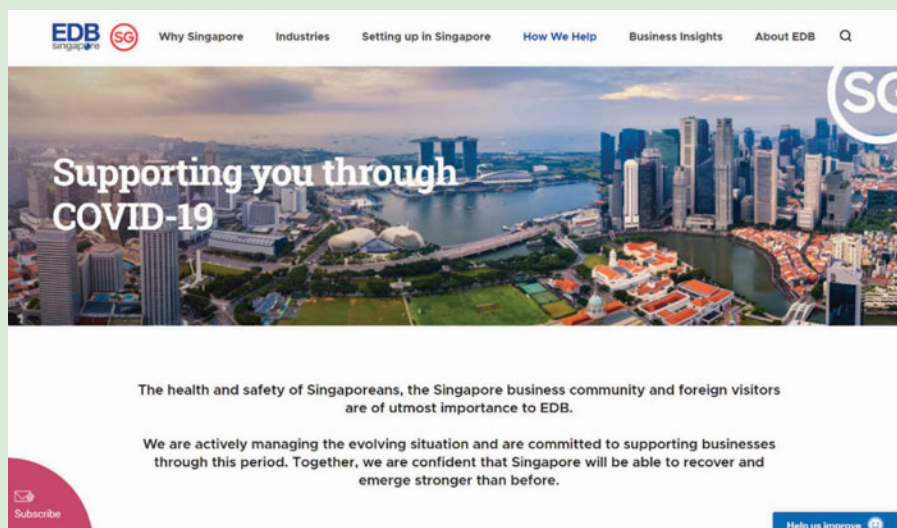


### COVID-related information in IPA websites

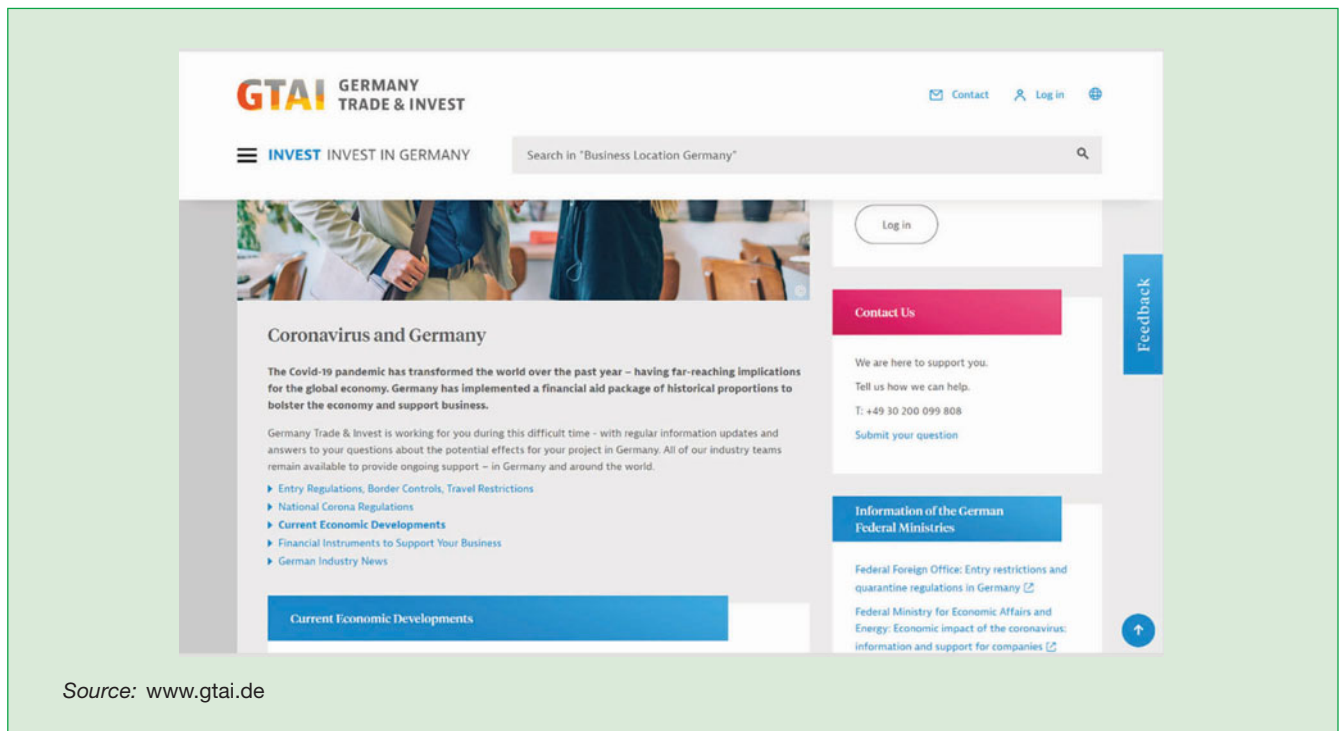
COVID-19 has highlighted that up-to-date, reliable and verifiable information on policy and legislative changes as well as in the general country and business environment are necessary for business to make right decisions. Recognizing this, IPAs across the globe have begun including COVID-19 updates on their website for investors. Information offered has typically included:

- National COVID-19 regulation updates;
- Current economic developments;
- Information for government schemes to support national and foreign businesses;
- Health and safety advice;
- Travel advice;
- Latest industrial insights related to the COVID.

Examples from the COVID-19 sections of Singapore's EDB and Germany's GTAI are provided below.



Source: Available from [www.edb.gov.sg](http://www.edb.gov.sg).

**Box 9.7** (continued)

Source: [www.gtai.de](http://www.gtai.de)

## 2. Use of social media

Social media, including LinkedIn, Facebook and Twitter, is increasingly being used by investors and site selectors. Social media allows IPAs to have frequent and effective communications and linkages with all stakeholders in real time. IPAs therefore need to have a strong presence on social media with direct links to and from their website.

The most important social media for IPAs are:

- LinkedIn ([www.linkedin.com](http://www.linkedin.com)): most active professional networking website.
- Shareslide ([www.shareslide.net](http://www.shareslide.net)), owned by LinkedIn:
  - Access to many slide and PDF presentations and a great way to market an IPA's message visually;
  - Re-purpose presentations;
  - Cross-link to other social media sites;
  - Largest community for sharing slides globally.
- Soundcloud ([www.soundcloud.com](http://www.soundcloud.com)):
  - Distributes the IPA message by voice through podcasts on smartphones.
- YouTube ([www.youtube.com](http://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.;

- Facebook ([www.facebook.com](http://www.facebook.com)), a global platform which can be used by IPAs to post messages, content, updates, events and pictures of the IPA or events;
- Instagram ([www.instagram.com](http://www.instagram.com)), owned by Facebook, is a platform on which IPAs can post their updates. When linked to a Facebook account the feeds will simultaneously be updated.
- Twitter: ([www.twitter.com](http://www.twitter.com))
  - Social networking and microblogging;
  - The SMS of the Internet;
  - Use Twitter Counter (<http://twittercounter.com>) for tracking and tracing, 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.

A recent survey highlighted the various ways that IPAs are using social media to promote and facilitate investment (table 9.6). For example, LinkedIn appears to be the preferred social media tool, and it is a popular tool for identifying and gathering information





**Box  
9.8**

### Social media campaigns conducted by Invest India

In order to promote its activities, the IPA in India is actively expanding its presence on social media platforms. Invest India is notably active on Instagram; where it posted more than 130 times from January to April 2021. These posts generally consist of informative facts or figures about the Indian economy and its industries, displayed in colourful and illustrative post designs. The agency uses a #didyouknow hashtag to increase the social media engagement of their posts. An example of such a “did you know” post is given below;



Source: Invest India (@investindiaofficial), 21 May 2021.

The agency also shares the advantages of investing in India and progress updates on investment projects. Next to traditional posts, the agency’s Instagram account is used to upload short animated videos giving more in-depth information about various industry developments and specific regional advantages for certain sectors.

During the COVID-19 pandemic its Instagram account has been used to share information regarding proper behaviour against the virus. Such posts include an explanation on how to limit the spread of the virus as well as providing information on vaccines.

Next to Instagram, the IPA is active on other social media platforms. Its LinkedIn agency profile, for example, regularly posts updates about its organization of, or participation in events together with informative posts that resemble those on its Instagram profile. The IPA is also active on Twitter, where it has more than 170,000 followers (May 2021), and on YouTube.

Invest India’s social media activities have been effective because they post regularly, in English, and make sure all their posts are clear and concise. They have also ensured that their social media accounts are visibly well-positioned on the home page of their website, and even offer plug-ins to receive up-to-date automatic notifications of posts.

on potential investors as well as for advertising investment opportunities. Facebook is a popular tool for engaging the wider public about an IPA’s activities and enhancing the image of the IPA. YouTube was also a popular tool for enhancing location attractiveness (World Bank and WAIPA, 2020).

Having dedicated staff and a budget for social media engagement is critical to making any social media campaign a success. Highlighting this, more than 80 per cent of the IPAs surveyed on social media tools, employed at least two full-time employees to run their social media programmes. Furthermore, more than half of surveyed IPAs spend US\$10,000 a year on their social media programmes; while over a quarter spend over US\$100,000 (World Bank and WAIPA, 2020).

Best practice digital IPA campaigns now typically comprise catchy tag lines and visuals capturing the main draws of their country or city. Each campaign is integrated across the IPAs’ various social media accounts, thereby enabling the campaign to be strategically cross-promoted with a variety of other local organizations.<sup>4</sup> Some have launched hashtag campaigns, advertising new projects or business successes in the city. Many have live SMS chat for queries, webinars, livestreams, podcasts and videos. Other websites run a news feed for prospective investors and/or newsletters offering readers an in-depth view into the latest local business developments. InvestHK applies an integrated approach to their online marketing and communications activities that includes advertising, social media, public relations activities and

<sup>4</sup> For example, see Kingston Economic Development Corporation (Canada) at <https://www.fdiintelligence.com/article/70510>



**Table  
9.6**

**Most effective social media for IPA core activities: Response rate of 74 IPAs**

	LinkedIn	YouTube	Twitter	Facebook	Google	Blogs
Identifying investors	71%	3%	3%	2%	14%	7%
Gating investor intelligence	58%	2%	5%	7%	16%	12%
Engaging/following investment promotion consultants	58%	4%	13%	10%	4%	10%
Arranging meetings	50%	2%	7%	11%	7%	9%
Advertising or sharing investment opportunities with investors	37%	10%	12%	25%	8%	5%
Enhancing the image of the IPA's location	26%	19%	22%	28%	3%	2%
Informing the general public about the value of the IPA's activities	19%	9%	17%	45%	5%	3%
Engaging/following other IPAs	34%	3%	19%	17%	7%	12%
Tracking what competing locations and IPAs are doing	31%	7%	19%	26%	9%	7%
Identifying and recruiting staff	76%	2%	2%	14%	2%	3%

Source: World Bank-WAIPA, 2020 and State of Investment Promotion Agencies.



**Box  
9.9**

**Examples of digital marketing**

Short video clips are one of the most effective ways of digital marketing. InvestHK engages actively in digital IPA campaigns with well-produced 2-minute case study videos to promote the city using the tag #WePickHK. In these short videos, investor and entrepreneurs introduce their journey in Hong Kong, why they choose Hong Kong and their insights on future market development in their sector. This vivid form of engagement has greatly increased engagement with potential investors.



Event live streaming is another important way to expand social influence and increase transparency. It can be used to prepare the annual report and policy briefing. For example, the Singapore Economic Development Board (EDB) livestreams its year-in-view press conference each year through Facebook, the Australian Trade and Investment performs its Annual Investment Statement and Investor Recognition Meeting on YouTube and Thailand's Board of Investment releases resolutions of its board meeting via Facebook live. Beyond this, live-streamed seminars, dialogues

sessions and forums are also other event types that IPAs can consider live-streaming on their social media platforms to engage with current and potential investors.

publications across two main websites (one for its StartmeupHK initiative). They also coordinate social media channels and online and email marketing campaigns. Some IPAs, including InvestHK, have even started their own mobile apps.

Despite the importance of the above-mentioned social media platforms some are, in fact, banned in certain countries in Asia-Pacific. In these instances, IPAs often need to seek recourse to national or regional level social media platforms as well to target potential investors in those countries. China, in particular, has many social media platforms developed by national giants such as Baidu, Alibaba, Tencent and Sina (collectively known as “BATS”). These platforms specialize in e-commerce, fintech and mobile communications. Some regional examples of social media tools are:

- Weibo ([www.weibo.com](http://www.weibo.com)), which resembles Twitter and is often used by subnational Chinese IPAs;
- Wechat ([www.wechat.com](http://www.wechat.com)), which is often used on Chinese IPA websites. For individuals, it is mostly used for chatting. IPAs use the wechat QR codes on their websites, which are always for official accounts. These accounts are more like a promotion platform on which IPAs can post articles, latest news, event promotional materials to the public and potential investors;
- QQ ([www.imqq.com](http://www.imqq.com)), which is a chat tool that can be downloaded;
- Telegram (<https://telegram.org/>), which is a global communication platform.

The use of social media platforms is not without risk, especially as they are not particular to any one business. An IPA cannot control the audience and the information it derives from social media websites. There is a risk that an IPA could portray a wrong image. It is therefore important that an IPA makes conscious choices as to which social media it will work with, and what is the purpose. The ability to provide informational value on these platforms enables IPAs to attract and retain the most relevant clients.

### 3. Further digitalizing investment promotion: virtual reality and virtual meetings

Travel restrictions related to the COVID-19 pandemic have prevented many IPAs, Free Zone staff and corporate investors from travelling and thereby limited the ability of IPAs to showcase their location value propositions, attract investors or organize site visits. The pandemic has underscored the importance of the Internet and web-based marketing, and many

IPAs have increasingly started turning to digital tools to promote their country or location. Nonetheless, many developing country IPAs are ill-prepared to transition to completely or largely digital investment promotion and retention activities, and consequently have had a harder time adjusting to new modalities and digital tools of investment promotion because they have had a much larger learning curve.

Several of the digital tools that IPAs have turned to during the COVID-19 pandemic have already been highlighted above, but a few more such tools have also emerged as a direct consequence of COVID-19 restrictions. Figure 9.5 highlights the activities that were already digitalized before the pandemic and those tools that have emerged based on the investment promotion and facilitation framework introduced in chapter 8 (figure 9.2). As in many other corporate environments, Zoom, Microsoft Teams and Skype have emerged as the online tools of choice for communication, while several IPAs have also increased their use of Podcasts and YouTube to showcase their destinations and investment opportunities.

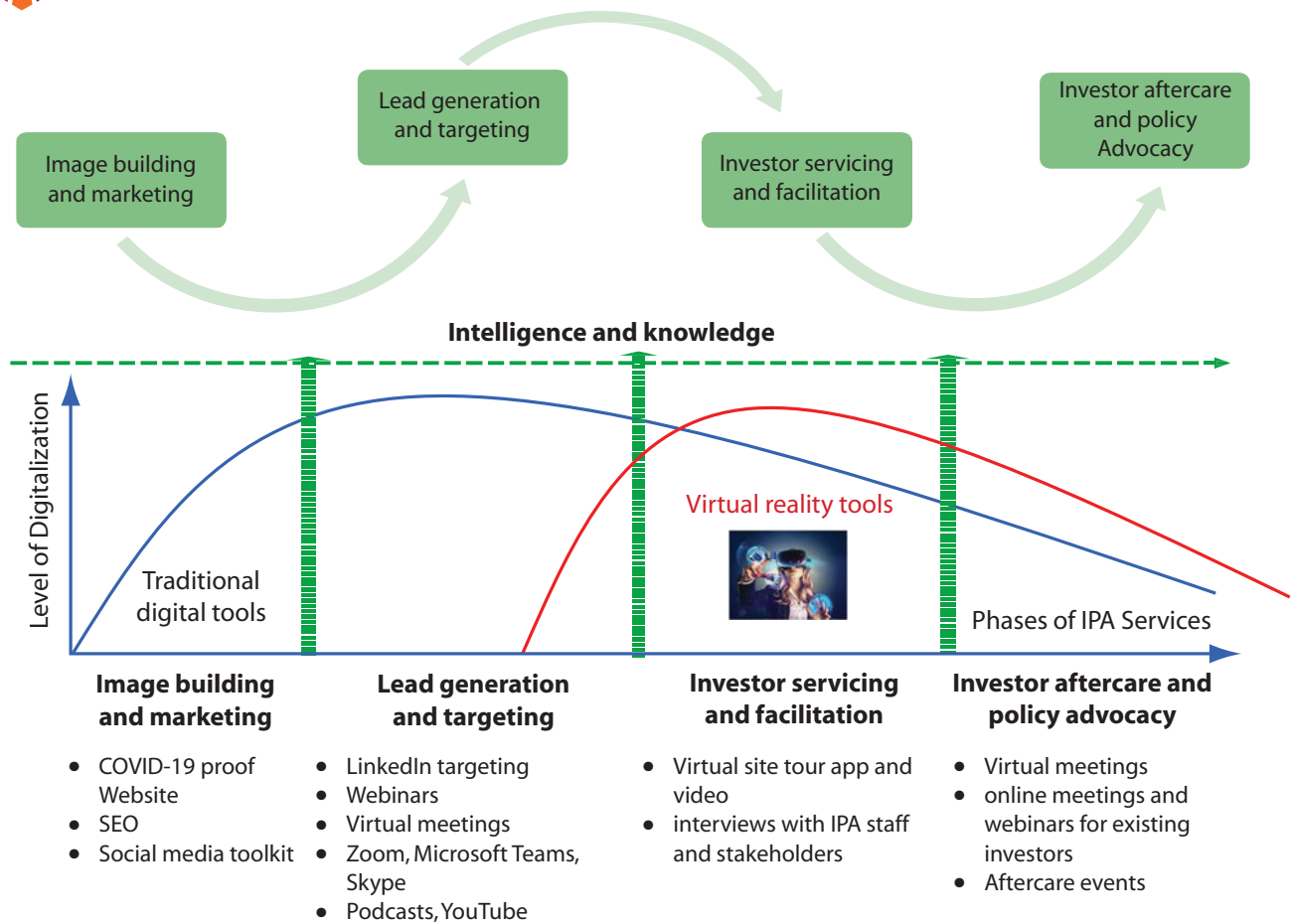
Virtual Reality (VR) – some IPAs in more developed markets have started to use VR to digitalize site visits; however, most IPAs are behind in adopting VR. COVID-19 has highlighted the fact that low adoption rates of VR represent a huge, missed opportunity for most IPAs. Had they adopted it before or early enough in the pandemic, they could have continued taking investors through the investment pipeline close to the announcement stage.

When considering adopting VR technology, IPAs should keep in mind how they intend to use it, how site visits can be organized through VR, what should be included and what type of corporate investors are most likely to engage with VR compared to the investment opportunities that are being promoted through VR.

Video-conferencing and virtual meetings – IPAs have suddenly been forced to turn to video conferencing and virtual meeting software to remotely pitch their countries to foreign audiences, showcase investment locations, and answer queries from interested parties. Between 2019 and 2020, 89% of IPAs surveyed globally by WAIPA and the World Bank had to postpone investment promotion events and 83% had to cancel all overseas travel (World Bank and WAIPA, 2020). While investment promotion activities came to a halt, they nonetheless had to digitally remain in touch with foreign firms already invested in their countries. They used tools like Zoom and Teams to handhold them through the COVID-19 pandemic, understanding their lockdown difficulties and helping



**Figure 9.7** Further digitalizing of IPA activities



Source: van den Berghe, 2020.

to find solutions, explaining government COVID-19 regulations and ensuring compliance.<sup>5</sup> The IPAs that were able to successfully do this had a better rate of retaining and expanding existing investments in their countries.

Some IPAs have also adapted to the new digital environment by using virtual meetings to remotely negotiate, conclude and facilitate investment deals with digital economy investors. One successful example is Pegatron Corporation's decision to invest in India after an entirely online interaction, all the way from the first point of contact with Invest India and months of detailed negotiations, to the final signing of the contract.

Below is a list of actions that IPAs can take to digitalize their activities throughout the entire life cycle:

1. Review the IPA's website recently and benchmark it with other best practice IPA websites in the region or globally. Even with limited resources, updating a website can be done very cost-effectively. For example, Wordpress or Wix can be used for website development tools;
2. Ensure the IPA's website contains the most relevant and up-to-date information about the location. Publishing "pdf" documents with information on the website is a cost-effective means for taking this action. IPAs can use

<sup>5</sup> This was supplemented with communication via websites, newsletters, and social media to update investors daily on developments related to the virus and government responses.

Google Analytics to assess and evaluate website traffic;

3. Develop a social media strategy and leverage the appropriate social tools. Regularly post short, clear and well-thought-out content to increase attention and followers. Some social media platforms that many IPAs have used to develop a social media presence are LinkedIn, Facebook, Instagram and Twitter;
4. Integrate digital tools to reach out and maintain contact with current and potential investors. Consider using these tools to hold online events and investor meetings;
5. Consider developing virtual site tours. Aerial views of your location can be developed quite easily with drones, or a company can be hired to develop virtual site tours. In some cases, the costs of developing a virtual site tour can be cheaper and more efficient than organizing several site tours for individual investors.

## E. An overview of other common investment promotion tools

### 1. Introduction

Many of the tools used for investor targeting can also be used to generate wider investor interest. Unlike in the case of image building, it is not simply the image of the country or the location that the IPA seeks to improve; it is, in essence, convincing investors that your location is the best choice for meeting investors' needs. These can include some of the tools discussed above in the context of image building as well as other promotional material such as brochures, sector profiles, investment proposals and newsletters. All material should be available on the IPA website.

When developing new promotional materials, an IPA should double-check its veracity and consistency with the IPA's other promotional messages. The effective distribution of marketing materials is also as important as the quality of the material itself. Too often, staff time and financial resources are devoted to the production of materials, yet little time is spent on planning how to get that material into the hands of targeted investors.

### 2. Investor brochures

From the outset of investment promotion, an 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. 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 FDI source countries. A good editor is essential for reviewing the brochure's layout and correct typographical errors, spelling mistakes, and formatting problems.

In general, the brochure should contain an overview of key information for investors, such as services provided by the IPA, investment statistics, 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.

Developing a high-quality IPA marketing brochure is a challenging task. In addition to the style guidelines presented in table 9.7, the following key principles should be kept in mind when developing the brochure:

- Remain objective, use independent sources and provide definitions;
- Provide relevant and accurate information;
- Communicate a clear message using correct language;
- Use appealing styles, visuals and content;
- Follow the KISS(S) principle: Keep It Short, Simple but Specific.

### 3. Sector profiles

Sector profiles provide specific information about sectors in which the location is deemed competitive. The focus should only be on developing materials for sectors assessed to offer the greatest potential for investment opportunities. Sectors lacking critical endowments or competitive factors should not be included, as investors will find other locations that offer such advantages. Box 9.10 provides a sample sector profile for fisheries in Fiji. Good sector profiles not only describe the features (e.g., species, amount of potential resources, production levels etc.) of a sector in a location, they also highlight advantageous cost factors or other competitive advantages, such as access to specialized processing facilities or transportation corridors.

In general, the following items should be included in a sector profile (van den Berghe, 2018):

- Sector description;
- Global FDI and trade trends of the sector;
- Key investment and location drivers of the sector;
- Country best practices in the sector;



**Summarized 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 MNEs) is appealing for investors.	All graphs and tables should be presented with a title and a source.

Source: Investment Consulting Associates, 2012, *IPA Handbook*.



### Sector profile for investment in Fiji – fisheries

Fiji possesses diverse resources of marine life species as well as a plethora of aquaculture products. The fisheries sector is pivotal in the overall growth and development of the country. The sector provides employment and income opportunities, access to food sources, sustainable livelihoods and, if properly managed, assists in maintaining balance in the ecosystem biodiversity. The fisheries industry is the third-largest natural resource-based sector in the economy, behind sugar and subsistence agriculture. In 2015, the sector grew by 3.6%, contributing around 1.8% to GDP and accounting for 12% of total export earnings.

The main contributor to the sector is commercial fishing, especially offshore tuna catches. Other contributors include *beche-de-mer*, aquaculture and other aquatic-based produce. The main commercial tuna species include big eye and yellowfin. These are high-value commodities that are largely destined for the Japanese and United States markets.

#### Duty exemption

Import duty exemption on the importation of raw materials, machinery and equipment (including parts and materials) required for the establishment of a business in the Tax-Free Region.

#### Other benefits under the TFR

An additional five years of income tax exemption is available to any company granted a licence and having indigenous Fijian landowner equity of at least 25%.

#### Opportunities

- Fiji has a very large Exclusive Economic Zone, which covers 1.29 million square km of ocean.
- Large stocks of marine resources such as tuna species of yellow fin, skipjack, albacore and big eye.
- Pacific Island countries in the western and central Pacific provide 54% of the world's tuna catch.
- Fiji produces some of the most beautiful pearls in the world.
- Opportunities for aquaculture farming for the tourism industry and exports.
- Huge potential for value-adding and niche markets.
- A variety of seaweed is also available in the Fiji waters.
- Fiji produces high-value commodities that are largely destined for the Japanese and United States markets in the form of fresh and chilled tuna (sashimi market) and loin fillets.

**Box 9.10** (continued)

- Fiji's 884,887 residents and nearly 800,000 tourists create a lucrative domestic market of more than 1.6 million people.
- The coastal waters, coastal mangroves and surrounding reefs have large stocks of fish, crabs, clams, shellfish, prawns, lobsters etc.

**Incentives**

Tax-Free regions are available to newly incorporated entities engaged in a new business established between 1 January 2018 and 31 December 2028 in the following areas: Vanua Levu – including Taveuni, Rabi, Kioa and other islands generally included for government administrative purposes in the Northern Division, and Rotuma, Kadavu, Levuka, Lomaiviti, Lau and Nausori-Lautoka region (from the Nausori Airport side of the Rewa River (excluding township boundary) to the Ba side of the Matawalu River. Any company may apply to the Minister for Economy in a prescribed form for an operating licence.

Tax exemptions are available. The income tax exemption is as follows:

- Capital investment from FJ\$250,000 to FJ\$1,000,000, for a period of 5 consecutive years;
- Capital investment from FJ\$1,000,000 to FJ\$2,000,000, for a period of 7 consecutive years;
- Capital investment above FJ\$2,000,000 for a period of 13 consecutive years.

Benefits under the Tax-Free Region:

- Duty concession on the importation of raw materials, machinery and equipment (including parts and materials) insofar as they are required for the establishment of the business at rates of Free Fiscal, Free Import Excise and 9% VAT.
- An additional five years of income tax exemption is available to any company granted a licence and having indigenous Fijian landowner equity of at least 25%.

Source: Investment Fiji. Available at <https://www.investmentfiji.org.fj/pages.cfm/for-investors/sector-industry-profiles/fisheries.html>

- SWOT analysis of the sector;
- Competitiveness of the sector;
- Best practice case study of a company in the sector;
- Productive ecosystem;
- Subsectors;
- Investment opportunities in the sector;
- LVP of the sector;
- Sustainable development trends and developments in the sector;
- Target markets;
- Recommendations.

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 containing 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. These profiles can therefore pave the way for matchmaking with foreign firms.

## 4. Investment project proposals

Investment project proposals (IPPs) are specifically defined projects in particular sectors or industries that foreign investors can invest in. Like opportunity profiles, IPPs can be crucial for FDI or matchmaking opportunities between foreign and domestic firms, as they can “advertise” joint venture opportunities this way to foreign investors. 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 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 per priority sector:

- Explore and evaluate investment opportunities;
- Use the provided investment proposal template to collect the data;
- Contact 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);
- Use external data and consultations with sector or industry experts to verify data.

## 5. Newsletters

Newsletters are commonly used by IPAs to keep investors up-to-date on what is happening in their location (figure 9.8). They are very effective in maintaining regular contact with investors and keeping locations in the limelight. For relatively new or small IPAs, newsletters can be prepared and distributed bi-monthly or quarterly as monthly newsletters may be too burdensome. The newsletter can be distributed via an e-mail distribution list and should also be published on the IPA website. A link to sign up to the newsletter distribution list should be included on the IPA website, and IPAs should also announce the release of each newsletter on their social media channels.

In addition to updates and news, a particular theme (e.g., policy reforms) or a selected sector (e.g., food processing) could be highlighted in the newsletter. Investors often find these types of newsletters very informative because they contain condensed information on a particular sector or a current issue of concern to investors. Effective newsletters also contain infographics to present key data relevant for investors.

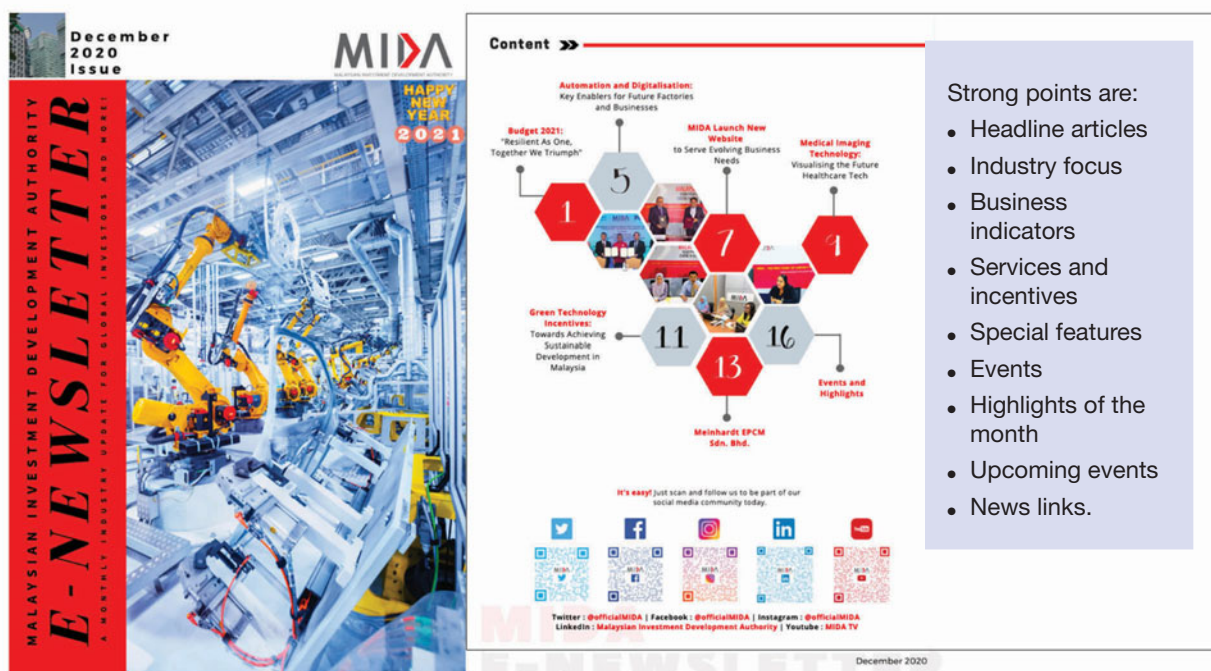
The following content can be included in newsletters:

- 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 its main regions;
- Interviews with investors and other stakeholders;
- What the international press says about the host country.



Figure 9.8

Best practice in investment promotion newsletter: Malaysian Investment Development Authority



- Strong points are:
- Headline articles
  - Industry focus
  - Business indicators
  - Services and incentives
  - Special features
  - Events
  - Highlights of the month
  - Upcoming events
  - News links.

Source: Available at <https://www.mida.gov.my/wp-content/uploads/2021/01/MIDA-Newsletter-December-2020-FINAL.pdf>

6. Other investment promotion tools

Other investment promotion tools include fact sheets, advertising campaigns, seminars and investment forums. Some of these tools are also used for image building and investor targeting.

**Fact sheets.** They should only be one to three pages in length and updated regularly. 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.

**Public relations and advertising.** An important part of most investment promotion campaigns is public relations, including: (a) the establishment of relations and contacts with key people in the media; (b) providing information, success stories, and testimonials; (c) hosting visiting journalists; and (d) monitoring media coverage. An IPA needs to systematically monitor its media coverage, especially the publications read by targeted investors, and assess the results. 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 and provide an opportunity for the agency to change its image; or (d) there is a change in strategic direction by the IPA, e.g., by focusing on new sectors or activities (Lowendahl, 2001).

Another form of investment promotion is advertising, which can be expensive. 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 for this purpose. Targeted advertising can also be used across social media channel and through Google advertising campaigns. Such campaigns can be more affordable depending on the settings that are used.

**Seminars, investment forums and conferences, and presentations.** Other investment promotion activities include: (a) speeches, seminars and presentations to business audiences; (b) “open houses” or hospitality sessions by the IPA; (c) participation in trade or investment shows or forums or other business events; and (d) briefings for key investor organizations and intermediaries.

The most successful investment seminars or conferences are sector-based and include presentations by satisfied investors (Loewendahl, 2001). As a result, private sector “champions” or “ambassadors” are frequently used for promotional purposes. For example, they are often asked to make formal presentations, participate in investment missions or 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 business persons are effective. Some may be critical or negative, poor public speakers or unknowledgeable about desired messages or specific policies. It is essential that the business champions are briefed beforehand about the IPA strategy so that they can remain on brand, and that those chosen to present to prospective investors are charismatic persons fluent in the audience’s language. It is also important to track and continuously assess their performance to ensure that they are being effectively used.

In conclusion, it is imperative that an IPA produces high-quality promotional material, such as those mentioned above, before embarking on the use of proactive investment promotion techniques, to first provide the basic information investors need to be interested in a location. The choice of specific types and the format (whether printed, electronic, video etc.) of materials and tools depends on several factors, such as an IPA’s budget, access to in-house skills for material preparation and production, and the investor type targeted. The IPA may need to experiment to find out which types of materials and formats work best for them. More recently, digital investment promotion also kicked off and the tools described should be incorporated into IPA websites, in addition to traditional distribution.

## F. Investor targeting and lead generation

### 1. What is investor targeting and lead generation?

As previous chapters have demonstrated, corporate site selectors and investors face information asymmetries and are influenced by perceptions (right or wrong) of certain sites. Direct marketing can provide information to potential investors that may positively affect their perception.

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 posing the highest potential for investment in a given country/location in

line with its competitive advantages and opportunities. Investor targeting is a technique to attract inward investment in greater quantity and quality, making the most effective use of limited resources (VCC, 2009). Harding and Javorcik (2010) found prioritized industries and sectors received twice as much FDI as non-targeted sectors in developing countries. It is thus an important part of a lead generation strategy of an IPA.

Most IPAs in developed countries now engage in some form investor targeting. The prime goal is to generate good quality business leads on investors, who otherwise would not have considered the location for investment. Investor targeting should involve solid relationship-building, including presenting well-researched niche “business opportunities” to specific senior managers of the targeted companies in order to enhance the quantity and quality of inward investment projects.

The main advantages of investor targeting are that efforts can be channelled and costs reduced, it can greatly increase investor and investment advisors’ awareness of the location as well as help investors respond to the material relevant to them and help develop local industry clusters. If an IPA is not able to undertake investor targeting in-house, it can be outsourced to specialist providers assuming the resources are available to do so.

There are five key principles to follow when undertaking investor targeting:

- Target industries and sectors before identifying specific companies and 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.

Staying in touch with targeted companies on a sustained basis is also important so that the IPA and location can be considered by the potential investor in the future. This is called lead generation.

### 2. Principles 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 depends on the specific circumstances of the IPA (VCC, 2009). For example:

- If a location has a large diaspora, 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 number of investment inquiries, then a first step may be the profiling of companies based on those inquiries (VCC, 2009).

Private sector approaches to investor targeting are increasingly 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 good quality business leads in securing future FDI projects. Results from approaching and contacting selected companies regularly often come after several years.

Experience demonstrates that the most successful approaches to investor targeting involve the establishment of links between IPAs, their existing investors and businesses, and the development of personal networks with target companies and intermediary organizations, including industry associations and investment multipliers like real

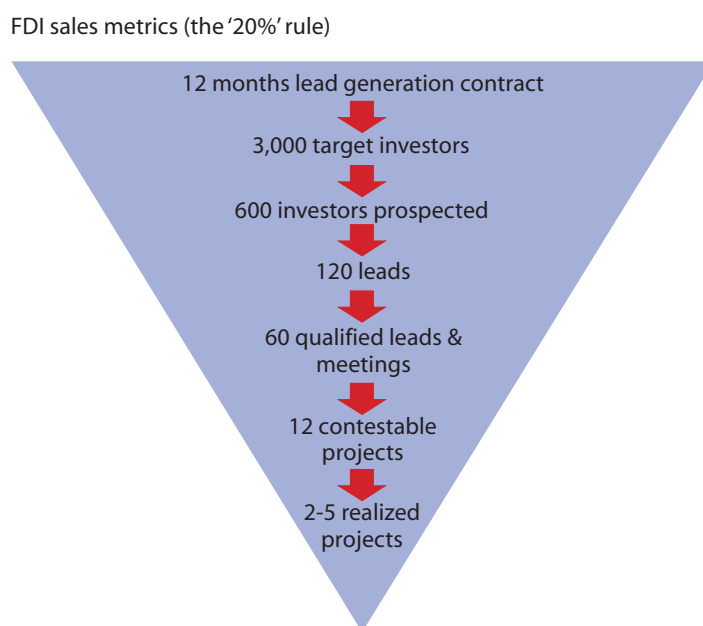
estate companies and location consultants. Sales representation has proved to be effective as long as it is performance driven. Directory listings and direct mail, on the other hand, have proved to be least effective.

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 a location in the medium term. Qualified leads are companies planning to invest in the location’s targeted sectors and would like to meet IPA representatives to organize site visits. Contestable projects are current projects that investors are considering implementing in the promoted location. It is critical for an IPA to quickly reduce the list of target companies to leads, qualified leads and contestable projects.

It typically takes 18-24 months from the first contact with a company to the time the company has a project the 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 per cent over the long term. Figure 9.9 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 short-listed (Loewendahl, 2005).



**From investment targeting to investment realization**



Sources: Loewendahl, 2005, and van den Berghe, 2016.

### 3. How to identify target industries

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;
- Where the location can fulfil the location requirements of the sector;
- Where the location can fulfil these requirements better than competing locations.

Sectors that offer specific advantages or activities (such as engaging in R&D) may be targeted to fulfil the FDI objective, such as headquarters establishment, technology transfer, R&D etc.

To identify target industries, IPAs should use a SWOT analysis and sector data to identify the top 5-10 sectors:

- In the location, ranked by size of the sector (e.g., by employment);
- That have already attracted investment, or contain the most successful firms;
- That are the fastest growing sectors in the location; or
- That existing investors see as having the best opportunities.

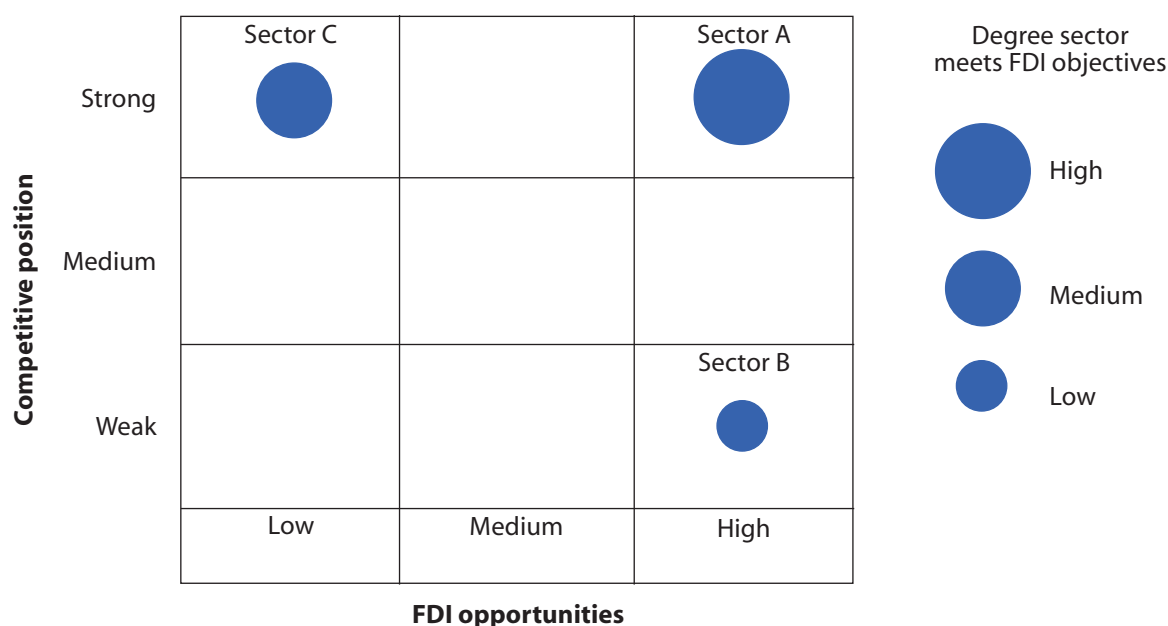
Aligning sectors with the strength of the location, while also identifying those that have the best prospects for FDI and make the greatest potential contribution to the local economy, and then prioritizing them. A competitive sector targeting framework using three dimensions, consisting of competitive position of the location, FDI growth opportunity and degree to which the sector meets the FDI objective, is presented in figure 9.10. The goal is to attract FDI in the sector in the right-hand top corner.

Targeted industries (and firm activities) should first and foremost meet the sustainable development objectives of the location. For example, in the case of Thailand, targeted industries are based on the promotion of industrial clusters (box 9.10). 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 focusing 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 to investors in those sectors. Table 9.8 presents a general industry/sector targeting methodology.

Various online tools are available to help IPAs to identify sectors for FDI attraction. One such tool is the Investment Map developed by the International Trade Centre (box 9.12).



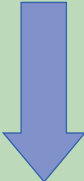



Identifying priority sectors for FDI



Source: Loewendahl, 2001.



**Table 9.8 Sector targeting methodology for FDI attraction**

Steps	Particulars/criteria
1. Preparation of an initial list  	<ul style="list-style-type: none"> <li>● Industry structure;</li> <li>● Growth trends;</li> <li>● Inward investment;</li> <li>● Industrial linkages;</li> <li>● Sustainable industries;</li> <li>● Import activity;</li> <li>● Policy to foster green growth;</li> <li>● Information transparency;</li> <li>● Institution and governance.</li> </ul>
2. Pre-screening using evaluative criteria  	<ul style="list-style-type: none"> <li>● Skill intensity ratios;</li> <li>● Technical sophistication;</li> <li>● Innovation propensity;</li> <li>● Transportation access requirements;</li> <li>● Production scale requirements;</li> <li>● Possible SDG impact;</li> <li>● Responsible business conduct.</li> </ul>
3. Analysis of industry-specific trends  	<ul style="list-style-type: none"> <li>● Production/technology trends (industry 4.0 or new sustainable industries);</li> <li>● Sustainable trends;</li> <li>● End-user market trends;</li> <li>● Customers and suppliers;</li> <li>● Barriers to entry;</li> <li>● Other competitive forces;</li> <li>● Environmental impact (carbon footprint, water risk, waste etc.)</li> </ul>
4. Locational fit analysis  	<ul style="list-style-type: none"> <li>● Location of key markets and suppliers;</li> <li>● Labour and skills requirements;</li> <li>● Facility requirements;</li> <li>● Transport and telecommunication requirements;</li> <li>● Infrastructure and utilities requirements;</li> <li>● Demand for renewable energy</li> <li>● Education/R&amp;D;</li> <li>● Business environment and quality of life.</li> </ul>
5. Identifying targets	

Source: Investment Consulting Associations.



**Box 9.11 Targeting sectors in Thailand, based on the cluster approach**

The focus of Thailand’s Board of Investment’s (BOI) seven-year investment promotion policy (2015–2021) is on the promotion and development of individual industrial clusters. The cluster policy objective is to develop potential and current 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, strengthen the value chain and contribute to the local economy. For that purpose, a distinction is made between so-called “super” clusters and other clusters for development and attraction of FDI.

Source: Thailand Board of Investment.



### International Trade Centre Investment Map

Investment Map is a web-based tracking tool that helps IPAs to 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 to identify competing countries 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 includes, inter alia:

- 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 15 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 more than 150,000 foreign affiliates located in developing countries and economies in transition.

Furthermore, direct links to other databases, such as the World Investment Directory, Market Access Map and Trade Map, are provided for a complete market assessment.

A limited version of Investment Map can be accessed without registration for the sector and country breakdown of FDI flows and stocks at Investment Map can be accessed at <http://www.investmentmap.org>.

*Source:* International Trade Centre.

## 4. Targeting companies

Targeting investors goes beyond sector targeting, and requires comprehensive research and analysis. The goal is to find companies that fit into the existing business environment (market-seeking FDI), the global and/or regional supply chains (efficiency seeking FDI) and/or enable the host country to better achieve the SDGs. Other criteria that IPAs may use to target investments include the form investment (greenfield, M&A and joint-venture), investor nationality, company size or a demonstrated commitment to responsible business conduct of investors.

Investor targeting requires dedicated resources as well as sector-specific and commercial understanding. As it is very time-intensive to identify, contact and build relations with key potential investors, a selective approach to maximize use of limited resources should be followed. The key to success is “managing the leads pipeline.” This means that, while an IPA should work towards always having a strong leads pipeline (i.e., a number of good quality investment leads) to achieve the level of inward investment sought, the leads pipeline should not be bigger than the IPA can manage. If it is bigger, it will be counter-productive to securing projects.

Two methods can be combined to most effectively identify target investors and maximize inward FDI potential – carefully conducting research to build a database of the potential investor(s), and simultaneously developing networks with relevant organizations to identify investment leads. 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).

Existing databases provide a good starting point for building a new database of potential investors. Ideally, an IPA should already have some form of CRM system that is used to capture records and update contacts with companies as well as record information on the quality of companies. The primary method to develop the database is to identify high-potential investors in each of the designated key target sectors. A filter is needed to draw up an initial list to screen companies and identify targets, ideally in major FDI home and trading countries. An alternative method is to observe competitor host countries in order 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, following their customers, competitors and suppliers overseas. An IPA then needs to consider whether it is in a position to provide a superior environment 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, including 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 (see box 9.13); however, not necessarily free of charge.

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 and key outcomes);
- Tracking of site visits;
- Tracking correspondence (faxes, letters, e-mail 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 IPAs.

The main networks that can be used for lead generation include:

- Existing foreign investors are not only a source of expansion and for upgrading investment projects. Through their networks of suppliers, customers, competitors and advisors they can also often provide considerable insights on investment decisions made by other companies in a particular sector;

- Local companies, especially those with international activities, are a good source of intelligence as to which foreign companies may potentially consider investing in a country/location;
- Cross-border partnerships with trade and enterprise development agencies and chambers of commerce, in the 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 with 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 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, an IPA may be in a position to be invited to visit the company, and present its product and promote its location. Important aspects of a successful location promotion presentation discussed above – box 9.13 lists important points to consider when making a holistic effective company presentation.

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. In order to maintain these personal relationships, the account executive should:



### Online resources and company databases

In order to build an investor database, an IPA can resort to online databases. Some are provided by international organizations such as ITC's Investment Map (box 9.11), while others are often country-specific. Therefore, they may be used in a complementary manner. Prominent examples include:

- **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](http://www.fdimarkets.com)) is a service from the *Financial Times* that is the most comprehensive online database of cross-border greenfield investments available. It covers all countries and sectors worldwide, and tracks and profiles companies investing overseas.
- **Strategis website** (<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.
- **EDGAR** (electronic data gathering analysis and retrieval) system (<http://www.sec.gov/edgarhp.htm>) established by the United States Securities and Exchange Commission (SEC).
- **EMIS** (<https://www.emis.com>) is a Euromoney institutional investor company that lists more than 1.4 million companies from trusted sources in more than 250 industries in more than 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 United States companies, all with sites on the Web.
- **Kompass** ([www.kompass.com](http://www.kompass.com)) systematic classification of companies in the 66 countries of the Kompass network according to the products and services they provide. The 58,000 entries in 26 languages are constantly updated and constitute a unique directory of development perspectives.
- **Vault** ([www.vault.com](http://www.vault.com)) provides profiles on thousands of companies through profile pages, rankings, survey data, and employer reviews. Primarily designed for job applicants.
- **CEIC** ([www.ceicdata.com](http://www.ceicdata.com)). CEIC Data's economic databases provide expansive and accurate data insights into more than 200 economies, with comprehensive coverage of China, India, Indonesia and other countries.
- **Influencers** ([www.wavteq.com/systems/wavteq-influencers](http://www.wavteq.com/systems/wavteq-influencers)). Wavteq Influencers is a unique online platform providing a complete solution for economic development organizations (EDOs) to connect with investment intermediaries in every country worldwide. It combines the power of data with Wavteq's global experience in investment attraction.
- **IncentivesFlow** ([www.wavteq.com/systems/wavteq-incentivesflow](http://www.wavteq.com/systems/wavteq-incentivesflow)). Wavteq's IncentivesFlow is the only global deal database that tracks real-time financial incentives awarded to companies for foreign and domestic investment projects. The database covers 113 countries and identifies more than 42,000 companies with incentivized expansion projects.
- **InvestmentFlow** ([www.wavteq.com/systems/wavteq-investmentflow](http://www.wavteq.com/systems/wavteq-investmentflow)). Wavteq InvestmentFlow is a suite of database platforms that track domestic investments in Australia, Canada and the United Kingdom.
- **China Global Investment Tracker (CGIT)** (<https://www.aei.org/china-global-investment-tracker>) is a comprehensive public data set covering China's global investment and construction. Published by the American Enterprise Institute (AEI), the CGIT includes 3,500 large transactions across a variety of sectors as well as 300 troubled transactions.
- **FDI365** ([www.fdi365.com](http://www.fdi365.com)) is an online business intelligence platform for economic development and investment attraction of professionals. Each company profile is custom-made, which in turn guarantees unrivalled data accuracy, quality and reliability. Developed by Research FDI.
- **GIS Planning** ([www.gisplanning.com](http://www.gisplanning.com)) is the world leader in online economic development solutions for corporate site selection.

Source: United Nations Economic and Social Commission for Asia and the Pacific (ESCAP).



- Provide regular updates to stay in contact;
- Manage and use his/her insight information as a result of his/her personal relationship;
- Listen carefully, act accordingly and keep promises;
- Keep confidentiality about whatever he/she learns.

IPAs are also moving to virtual methods of lead generation as travel has been curtailed and events cancelled as a result of the COVID-19 pandemic. There have been mixed results. To build relations with major investors – especially those in Asia – traditionally required face-to-face meetings and it has thus been very hard to generate new FDI project confirmations during the pandemic. At the same time,



### Making an effective company presentation

When the responsible IPA 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 possible about the company, using Internet resources and the information used when first identifying the company as a target.

The presentation should incorporate the following:

- Ask the company to clarify their specific project interests before outlining the structure and content of your 20-minute presentation. If necessary, adjust your presentation to make sure these interests are adequately addressed;
- When making the presentation, use the following techniques:
  1. Develop an attention-grabbing introduction (short, concise, anecdote);
  2. Prepare and utilize visual aids. Use colourful PowerPoint slides;
  3. Make sure the visual presentation provides relevant information and outlines benefits for the company. Do not clutter the slides with too much text or information. Make sure there are no spelling mistakes;
  4. Be persuasive and support any questions/objections/queries with facts, logical arguments, and independent and truthful testimonials;
  5. Maintain eye contact with the audience. Do not simply read off the slides;
  6. Keep to the time allotted for the presentation.
- Outline the type of visit programme you can prepare for the company.
- Know regularly scheduled flights to emphasize the convenience of visiting your location.
- Use the meeting to learn as much as possible about the company's intentions. For example, ask questions about: (a) other countries on the company's shortlist; (b) key factors in their selection of a location; (c) details of the size and type of their investment; and (d) the decision-making process (time-frame, who makes the decision, who influences the decision, who might block). Ideally, prior research allows for more detailed questions, which give the impression you have done your homework and are genuinely interested in the company's investment. Try to identify the company's existing perceptions and concerns.
- Press for visit dates that could be conveniently scheduled.
- 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.
- At the end of the meeting, summarize precisely the key decisions and actions needed and confirm the timeframe of response.
- Within 24 hours send a courtesy e-mail to the participants, confirming the actions agreed upon.
- 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).



### Making an effective company presentation in a virtual environment

In order to overcome potential physical distance barriers between a prospective investor and the IPA, the ability to provide effective presentations in a virtual environment is crucial. While the occurrence of virtual meetings has peaked during the COVID-19 pandemic, the liberty and flexibility that virtual presentations offer may contribute to its standardization across sectors.

The following pointers should be considered when organising a virtual presentation:

- Consult available and suitable virtual presentation software tools. Some may require each participant's contact information for access, others may the number of participants allowed in the virtual environment;
- In preparation for the virtual presentation verify connectivity bandwidth and technical functionality, and specify the time zone;
- When holding the virtual presentation, make sure to mute your microphone during participants' questions and remarks, and ensure your background is free of personal items or chose a virtual one.

Source: <https://ose.stanford.edu/plan-event/virtual-support/guide-planning-virtual-event>

virtual lead generation methods, including multi-touch virtual outreach and investment webinars, have been effective in many cases. IPAs have also learned – by having no option other than virtual outreach – how important strategic investor research is to identifying the right investors to approach (especially with data protection rules like, for example, the General Data Protection Regulation in the European Union preventing mass mailing). These IPAs will certainly emerge from the pandemic with stronger capabilities, especially in digital methods like investor webinars, which will continue. At the same time, the pandemic has also illustrated the value of overseas representatives in key markets and as a result more IPAs are looking to establish overseas representatives.

## 5. Summary of key investor targeting principles

In conclusion, the following 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, for example, [www.fdiprofessionals.com](http://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. For example, these can be organizations that all benefit from an increase of new investors who may also require their services. Think about accountancy firms, infrastructure service providers etc.;
- 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 in 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-ups and relationship building;

- Manage the sales process strategically with a web-based CRM system;
- Aim for a conversion rate of 20 per cent on leads, prospects, and active cases;
- Apply a time limit/cut-off point on follow-up and closure.

## G. Investment promotion and targeting for sustainable FDI

Using FDI to help achieve the SDGs requires tangible actions and outputs throughout all phases of investment promotion activities, and the SDGs must be embedded in aftercare and policy advocacy activities. Yet, few IPAs have carried out such activities. Some of the main reasons for this have been identified as listed below (Wavteq and ICA, 2017; Wavteq, 2018):

- IPAs are executing functionalities of their Governments and lack the autonomy to evaluate or drive policies independently from national guidelines and their mandate;
- There is intense competition between IPAs to secure investment projects and create the most jobs, resulting in sustainable development being seen as a risk to securing new investment and jobs;
- Different views and attitudes towards the concept of sustainability prevent common strategies for sustainable development;
- In most cases, an IPA cannot afford to lose an investor or it will not reach its projects, jobs and capital investment targets;
- In most cases, IPAs may target sectors which have a clear sustainable development impact (e.g., renewable energy), but most do not go beyond this, and instead are still targeting achievement of traditional FDI metrics focused on investment volume and number of jobs created;
- Many IPAs are unfamiliar with how to incorporate sustainable development criteria into their promotion activities and perceive it as complicated;
- A vision change and a mission change is needed if IPAs are to develop and implement sustainable FDI strategies, which requires the Government to drive this as well as be willing to change investment incentive schemes.

Developing sustainable FDI promotion strategies requires a multidimensional approach covering sector strategy, investment services and investor targeting, which can be applied to all sectors. Furthermore, the

IPAs need to include sustainable development as a key part of their policy advocacy, particularly relating to investment incentives and Free Zones. Specific targets should be put in place for sustainable investment (e.g., x per cent of FDI projects, jobs and capital investment should be in sustainable development priority sectors).

Sustainable development related sectors and projects that should be targeted include:

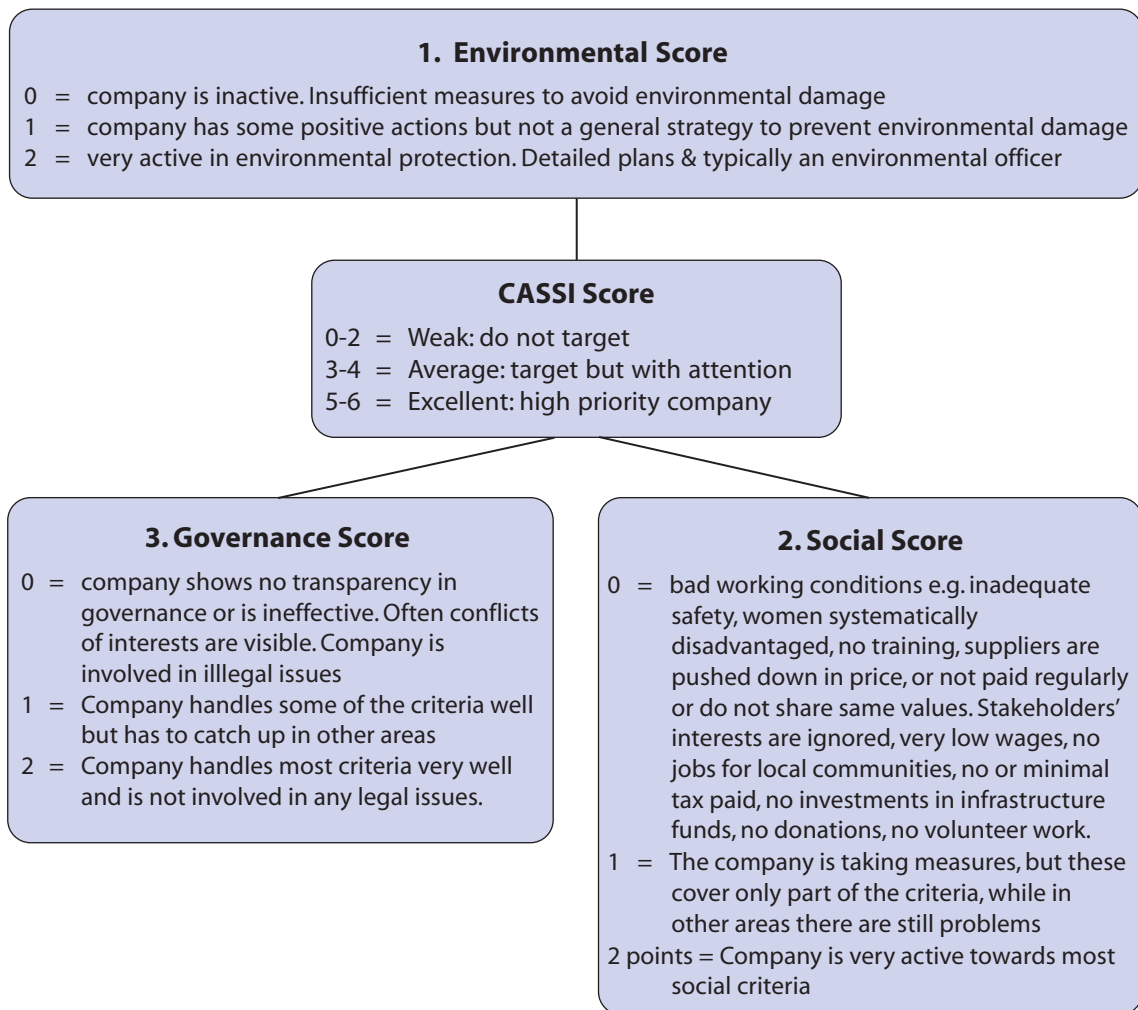
- Sectors where FDI can have a direct impact on sustainable development, such as renewable energy investment projects, eco-tourism, organic agriculture and other sustainable development activities;
- Sectors where FDI can play an indirect role, especially through technology transfer and specialist services (e.g., microcredits – financial services) and products that address key sustainable development threats facing the location;
- The types of projects within all target sectors that minimize anti-planet threats caused by pollution, natural resource depletion and intensive agriculture, inter alia, using tools such as the sustainable investment sector assessment framework provided below.

Furthermore, IPAs must understand regulatory frameworks related to sustainable development to be able to attract sustainable FDI. For example, detailed knowledge of the feed-in tariffs and building rules for a renewable energy plant or the contract processes to bid for a public-private partnership (PPP) sustainable development project are crucial to providing value-added investment services to investors. Equipping the IPA with staff with the right kind of knowledge is therefore essential. For example, when promoting renewable energy investment opportunities IPAs may consider recruiting regulatory experts or building the expertise of existing staff.

During the investor targeting stage of the investment promotion life cycle, IPAs can consider using the WAVTEQ Company Assessment Scorecard for Sustainable Investment (CASSI) to prioritize and rank companies according to their sustainable development investments (figure 9.11). Once the IPA receives an investment project proposal from a potential investor, it can deploy the sustainable FDI project indicators developed by ESCAP to assess how much that individual project will contribute to the sustainable development priorities of their country. These indicators are available online at General and Sector Specific Sustainable FDI Indicators.



**Company Assessment Scorecard for Sustainable Investment (CASSI)**



Source: WAVTEQ, 2017.

## H. 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. Does your country/location have a positive image with overseas investors? If not, what can you do to improve it?
3. What are the goals and objectives of your IPA (please describe)? If not, what could be the goals and objectives of your IPA?
4. Does your IPA have a mission and vision statement (please describe)? If not, what could be an applicable mission or vision?
5. 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?
6. Can you describe your IPA's social media strategy and how effective this is?
7. 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?
8. Describe how the COVID-19 pandemic has affected your investment promotion activities?
9. To what extent have you digitalized your investment promotion activities? Which tools have become more important and what is the result?
10. Are you considering building VR tools to provide investors with a virtual site tour?
11. 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?
12. Does your IPA engage in reactive or pro-active investment promotion? Considering all your investment promotion efforts, are they focused and cost-effective?
13. 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?
14. Does your IPA engage in active sector/industry, 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?
15. Describe the research steps you take to describe how you have identified your key target sectors of your IPA?
16. How has your IPA incorporated sustainable development into the investment promotion lifecycle? To what extent do the SDGs play a role in targeting specific investors?



## CHAPTER



# Investment facilitation and aftercare

## A. Improving the investment realization rate: Introducing investment facilitation

In many cases, not all announced or approved investment is actually realized. Regulatory and procedural obstacles in obtaining permits; lack of sufficient infrastructural facilities; non-cooperation from local government or inefficient IPAs; problems with financing; corruption; absence of aftercare; lack of capacity of domestic partners; conflicts, etc are some of the reasons why announced investment might not be realized. This chapter focuses on the last two phases of the investment promotion life cycle and framework as highlighted in chapter 8, figure 8.2.

Investment facilitation services that an IPA offers are important throughout the entire investment promotion life cycle (table 10.1). The goal of investment facilitation is therefore to facilitate initial investment, retain that investment and expand it.

Investment facilitation has been 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 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.



**Investment facilitation throughout the investment promotion cycle**

Investment promotion stage	Investment facilitation activities
Pre-establishment (focus on active investment <b>promotion</b> ).	<ul style="list-style-type: none"> <li>● Provision of all required and relevant information to the investor in order to “facilitate” the decision of the investor in favour of the host location;</li> <li>● Setting up meetings as required with potential customers, government agencies etc.;</li> <li>● Preparing for and conducting the site visit.</li> </ul>
Establishment (construction) (focus on investment <b>generation</b> ).	<ul style="list-style-type: none"> <li>● Act as “one-stop shop” – helping with obtaining an investment licence: construction, work and residence permits; access to land and buildings (lease, purchase of properties), labour, finance etc.</li> </ul>
Post-establishment (aftercare) (focus on investment <b>facilitation</b> ).	<ul style="list-style-type: none"> <li>● Troubleshooting problems encountered by investors during production, e.g., with labour, utilities, permits etc.;</li> <li>● Managing inspections;</li> <li>● Managing (minimizing) other bureaucratic harassment and corruption.</li> </ul>

Source: ESCAP.

Best practices have shown that investment facilitation, in which home and host countries both become involved, is the most important function of an IPA and often takes more time than investment promotion-related activities. Across the investment promotion life cycle, policies and strategies focused on investment facilitation is often most overlooked in the post-establishment phase is often. For example, of the 173 new investment-related policies introduced globally between 2010 and 2015, roughly 50% introduced investment incentives, while only 23% focused on investment facilitation (UNCTAD, 2016). Results from a survey of IPAs globally by the World Bank and WAIPA (2020) also underscore the fact that most IPA investment facilitation services are focused on attraction entry in the establishment phase of a project, and far fewer are focused on post-establishment servicing.

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 keeping the investor happy and ensuring that the investment is actually realized. Without investment realization, investment promotion is rather meaningless. Furthermore, happy investors are the best advertisement for any location, and existing investors can act as ambassadors in helping the country to 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. Investment facilitation, particularly aftercare, is therefore essential to investment promotion and the IPA should provide adequate facilities and resources

for this purpose. Moreover, aftercare measures aimed at investment retention have become even more critical during COVID-19.

Investment facilitation entails some key aspects that IPAs should carefully consider:

- Investment facilitation entails the entire project cycle, from initial inquiry to providing aftercare services;
- Keep a service mentality at all times, and bear in mind the investors are your customers;
- Good preparation is critical for successful meetings with investors;
- Problems should be detected at an early stage, but this can only be achieved through proactive contacts with investors from the beginning;
- Problems or requests for information or support should be dealt with in a timely manner;
- It should be recognized that start-ups need more sustained help, and that smaller firms have different needs and capabilities to those of large MNEs;
- 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 the private sector and other government agencies in order to provide investors with a variety of contacts, and to assist investors in overcoming bureaucratic hurdles and related obstacles.



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 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 foreign investment market. Box 10.1 lists the 14 practices.



### **Fourteen 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 as

well as options that can guide international collaboration or that can be incorporated in IIAs. The Menu, which is based on UNCTAD's Investment Policy Framework for Sustainable Development, can be accessed at <http://investmentpolicyhub.unctad.org/Upload/Documents/UNCTAD.GlobalActionMenuForInvestmentFacilitation.v4.16.09.2016.pdf>.

Recently, there have been extensive discussions on developing an investment facilitation (not investment promotion) framework for development at the WTO. From the outset, the negotiations excluded issues related to market access, investment protection and ISDS. Instead, the negotiations have prioritized

“improving the transparency and predictability of investment frameworks, streamlining procedures related to foreign investors, and enhancing coordination and cooperation between stakeholders, such as the host- and home-country Governments, foreign investors, domestic corporations and societal

actors” (Berger and others, 2021). To this end, A number of concrete measures have been proposed (Sauvant and others, 2020) and negotiations for an international agreement containing such measures began among more than 100 WTO members in late-2020 (box 10.2).



### ITC and DIE investment facilitation measures and the Investment for Development Negotiations

The International Trade Centre (ITC) and the German Development Institute (DIE) in collaboration with the World Economic Forum (WEF) have developed “An Inventory of Concrete Measures to Facilitate the Flow of Sustainable FDI: What? Why? How?” as part of a broader project on the subject matter. This work has been prepared in the framework of the ITC/DIE Project on Investment Facilitation for Development. Other parts of the project include the development of an investment facilitation for development index to measure the status of investment implementation globally, and capacity-building workshops and dialogues (including one recently held in Asia and the Pacific) across the globe on the topic. The project supports the negotiations of a multilateral framework on investment facilitation for development.

The Inventory that the project has developed serves as a capacity-building tool to help countries engage in the WTO negotiations. It is an informal compilation of investment facilitation measures, their rationale and ways in which these measures are – or can be – implemented in practice. However, following the agreed scope of the WTO negotiations, it does not include measures related to investment protection, ISDS and market access. Moreover, the Inventory does not address the conceptual distinction between investment promotion and investment facilitation measures; hence, some measures in the Inventory may be categorised by some as investment promotion measures. Independently of the Structured Discussions, the Inventory may also be of interest to investment promotion agencies seeking to facilitate FDI.

The Inventory has been discussed extensively in a large number of commentary and expert group meetings as well as capacity-building workshops, and was shared with WTO for further discussions in 2021. The commentary groups’ meetings reports, in collaboration with the WEF, can be found at <https://www.intracen.org/itc/Investment-Facilitation-for-Development/>

## B. Investment facilitation in the pre-establishment phase of investment: Investor inquiries and site visit preparation

### 1. Investor inquiries

Handling investor inquiries as professionally and effectively as possible is critical to the success of a location in attracting inward investment, and it is also a core component of investment facilitation services. 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 Internet becomes more prominent in investment attraction.

Investor inquiries are required at various levels throughout the investment promotion cycle. The tasks of an IPA correspond 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 term. 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). Table 10.2 categorizes IPA performance in dealing with investor enquiries.

Effectively responding to investor inquiries involves understanding investor needs and location requirements. In most cases, IPAs can anticipate what investors need and pro-actively provide substantive information on their websites, including FAQs. UNCTAD helps countries provide information on their investment regulations for the entire investment project cycle through a project called Regulations (box 10.3).



**GIPB categorization of IPAs in terms of dealing with investor inquiries**

Category	What it involves
Best practice	IPA provides a well-presented, thorough response. It goes beyond answering the questions to advocate for the location's selection, then diligent follow-up on the project's progress. It 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 the investor's lists depends on the level of service and diligence of similar profile competitors.
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; some opportunities are probably lost.
Weak	Provides a very limited response, answering few of the investor's questions or merely referring 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 below 10% indicates little or no contact could be made via email or telephone. The IPA will not be regarded as a viable business partner, leaving a very poor impression of the location.

Source: World Bank, 2012.

When IPAs receive an investor inquiry, its importance should be screened. Not all inquiries deserve a similar quality response. 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. If the query is not specifically from a firm in a targeted sector, further due diligence by the IPA is necessary to assess the potential of the investment project. An IPA's limited capacity prevents them from providing similar quality responses to all inquiries. If inquiries are from individuals the IPA should be more critical. Key questions in the due diligence process include:

- Is the inquiry from a targeted sector?
- What is the nature of the inquiry and can a good response be provided in time?
- In the case of individual inquiries, has the individual successfully made investments before (with sufficient evidence)? Which firm does the individual represent?
- Does he/she have a corporate email address (or simple Gmail, Hotmail, Yahoo e-mail address?) What is the specific question?
- Does the individual have the financial means to make an investment (with evidence)? Or are they only asking about incentive opportunities?
- Are there credible references for the individual?
- Why is the individual interested in your country and do they have ties to your location (do they know other companies, relatives etc.)?

There are four dimensions of effective inquiry handling – availability and contact-ability, responsiveness and handling, response quality, and ongoing customer care – in an integrated system that is continuously monitored for improvement (World Bank, 2012). Each of these dimensions is discussed below in further detail.

*(a) Availability and contact-ability*

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. 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. IPAs should conform to good business practice when answering the telephone.

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. This way, the call can then



### UNCTAD's eRegulations in Viet Nam

UNCTAD has developed eRegulations to ensure 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 the process is outlined, together with name and contact details of the people responsible. Details are provided about the necessary forms, processing times, fees and the relevant legal requirements.

The programme has implemented 44 eRegulations systems and 4 eRegistrations systems in 28 countries worldwide since 2005. The eRegulations system is a Content Management System (CMS). All texts, colours, pictures and logos of the public interface can be modified, procedures and all the corresponding data can be registered and updated, menus can be organized and administration rights can easily be configured from an administrative interface. Information is displayed through a user-friendly, public website. Users can interact with the site and its administrators online, for any inquiry, suggestion or complaint. Procedures are clarified or simplified, resulting in faster operations and spurring investment, business activity and job creation.

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 (and procedure), the following information is provided:

- 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.

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 eRegulations systems operational in seven provinces (Hanoi, Da Nang, Ho Chi Minh City, Binh Dinh, Hai Duong, Phu Yen and Vinh Phuc) are also accessible via a national portal. This allows a comparison of procedures among provinces, making it easier to identify best practices, detect unnecessary steps and requirements, and streamline and harmonize procedures. The eRegulations Vietnam portal is an effective step for the Government of Viet Nam to increase public agencies' transparency, integrity and accountability. Thanks to this effort, eRegulations Vietnam provides a hands-on tool in Viet Nam's efforts to fight corruption and has been listed and ranked among the best in the Global Enterprise Registration portal, which lists and rates the user-friendliness of official business registration websites worldwide.

More information on UNCTAD's eRegulations system can be obtained from <http://businessfacilitation.org/eregulations/overview> and for Viet Nam's specific eRegulations system, see <https://vietnam.eregulations.org>

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.

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.

*(b) Responsiveness and handling*

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 time frame when a full response will be sent;
- Listen, summarize and understand the inquiry (in the 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.

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, yet targeted at non-priority sectors. Following up on such inquiries first requires an immediate response (less than 24 hours) and second a more thorough response (maximum five days later). Experienced officers using phone calls are a desirable means of answering such inquiries. Follow-up is desirable after some time. The third and most intensive level consists of project-related and strategic priority inquiries and needs to be addressed by sector specialists. Again, an interim reply of 24 hours is necessary, followed up by a thorough and intensively researched reply five days later. 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 specify the timeframe for a full response in its initial response. During this period, the 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.

*(c) The quality of response*

It is good practice to answer all of 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 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 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 asked yet. Being able to provide additional relevant information helps to 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 that interaction with the IPA is desirable, ensuring ongoing involvement in the project.

*(d) Customer care and monitoring*

Best-practice IPAs also try to contact the investor within two weeks of responding to the inquiry in order 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.

## 2. Preparing the site visit

Investment facilitation in the pre-establishment phase is mostly about providing accurate, timely and up-to-date information to potential investors, in particular about the overall investment climate and possible locations in the host country of the IPA. However, new investors do not make significant investments based on desk research and benchmark studies alone. They need to verify and validate the data and analyses with site visits, which is mandatory for a

well-informed investment decision. If a proposal and overall professional approach adopted by the IPA convince an investor that a project can be realized faster than elsewhere, it is more than halfway to winning the project. The next important step is preparing for, and conducting the site visit.

A site visit is a tailored programme that allows an IPA to showcase the local and regional business climate as well as available investment opportunities and facilities to the investor. It is thus an excellent opportunity to positively influence the decision-making of potential investors. However, organizing a site visit requires much time and resources, and local IPAs or local IPA branches should thus only consider organizing visits in response to an official investment inquiry or proposal by an investor. Organizing site visits is part and parcel of an IPA's pre-establishment investment facilitation role. The more relevant and detailed information the IPA can gather to meet investor needs in advance, the better its position to properly prepare and tailor the site visit in accordance with the investor's needs. For example, the IPA ought to be clear about an 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 resources;
- Logistics and utilities, energy;
- Link to suppliers (time and distance);
- Link to markets (wholesalers/retailers/consumers, and time and distance).

During the site visit, strong coordination and introductions to relevant organizations, individuals and other investors are crucial. If the IPA knows who will make up the site visit team this process can be optimized. The team may consist of senior officials of the company, an official based in the location where the new investment is to be made as well as:

- Senior manager with project team oversight;
- Human resources manager, who will assess aspects of the labour market and education system;
- Operations manager, who will assess all operational aspects;
- Real estate manager, who will evaluate real estate issues (logistics, equipment access, etc.);
- Information and communications technology (ICT) manager, who will need to understand all

connectivity, telecom, power and equipment-related issues;

- Security manager, who will assess risk to company employees.

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, i.e., on the basis of what criteria. Often, the site selection is conducted by consultants, e.g., a leading accounting firm, an engineering firm, value broker, architect or real estate broker firm, professional site consultants, special in-house project teams, top management, international business associates or existing investor representative offices in the host country (which would demonstrate investor interest 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 and are coming to the site with specific objectives in mind.

Most investors systematically evaluate the attributes of the candidate locations in terms of specific, detailed criteria, using a site selection matrix that is identical but more detailed than a general benchmarking exercise (see chapter 9). Such a matrix can thus 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. The IPA needs to know what the company is looking for, in order to estimate the weights investors would use. Some categories of comparison include market dimension, manpower availability, return on investment etc.

IPAs further need to set up a programme of meetings for investors with local industries and service providers, existing investors, local suppliers and relevant government ministries or departments. A sample list is given in box 10.4.

The IPA should assign one officer to manage the entire visit ("account executive" approach), so that prospective investors know who is handling the visit and can address all requests to that person, and that there is clear accountability. If the visiting company is a major one, a senior IPA official should manage the site visit to emphasize the importance of that particular investor.



### Preparing and conducting site visits: Whom to meet?

- 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 key points to be considered 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 language or in English (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 for the 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 that 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 time frame for deciding the start date and the value of the investment;
- Knowing who will be attending from the company, 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 time investors and investors from smaller companies, and anticipate language barriers;

- Mix business with pleasure – invite the investor to a local restaurant, cultural show etc.;
- Anticipate difficult questions and know competing locations' strengths and weaknesses.

### 3. Conducting the site visit

The site visit should take place on the basis of a carefully prepared schedule that accommodates the investor's requests. Meetings should not be hurried, and ample time should be allocated for each visit. The following points need to be carefully considered by the IPA and individual account executives when conducting the visit:

- Ensure that the investment officer is thoroughly conversant with the programme, places that will be visited and the people who will be interviewed;
- Ensure the transport person/driver is familiar with the locations that will be visited;
- Ensure 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 previous visit to the company there is no need to duplicate;
- 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, such as quality of life issues (box 10.5). Rapid post-visit follow-up is critical for landing the investment, and shows the IPA's commitment and credibility. The site visit manager should work immediately on gathering the additional requested

information, particularly if it must come from another agency, 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 regularly contact investors (but not too often).



### 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 as 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).
- Show them that it will be a fun and interesting location to operate from, too!

Sources: ESCAP; Investment Consulting Associates.

## C. Investment facilitation: Establishment phase

Investment promotion has paid off – a major investor has agreed to set up a manufacturing facility in a particular location! However, the IPA may still risk losing the investment if it does not carefully guide the investor through the establishment phase. During the establishment and post-establishment stages, the IPA is no longer doing investment promotion, only investment facilitation. If left to its own devices to manage the establishment, the investor may be put off by the many requirements and administrative procedures, and pull out. Investment facilitation is therefore essential. Below is a list of establishment requirements that require the assistance of the IPA; 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.

- Visa and work permit, residence registration;
- Company registration;
- Licensing issues;
- Healthcare and labour items;
- Bank and financial items;
- Building permits;
- Zoning requirements;
- Water, electricity and supply issues.

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, but sometimes is a stand-alone facility, particularly 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;
- Answer routine e-mail and telephone inquiries requesting information;
- Perform specialized searches for information not readily available to others;
- Alert IPA colleagues about deficiencies in the "off-the-shelf" or "off-the-web" information available in response to frequently asked questions;
- Put investors in direct contact with relevant (IPA) officials when a particular question or problem cannot be dealt with immediately by ISC staff;
- Assist investors in solving problems related to doing business;
- Business partner identification and matchmaking;
- Provide the necessary official forms and contacts that any investor needs to set up a business in that country;
- Investor follow-up and aftercare;
- Receive visitors, including scheduled visitors and unscheduled walk-in visitors;



- Assist investors in accessing information on the IPA, other government agencies (often representatives from these agencies are stationed in the ISC), and useful websites.
- There is no uniform prescription of effective ISCs, but certain key success factors can be identified (table 10.3).



**Key success factors for an effective ISC**

Show high-level political support.	The 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 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 on-going 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.
Have a good digital presence as IPA	Easy to navigate website which contains all relevant and appropriate information and services the IPA can provide

Source: Investment Consulting Associates.

Matchmaking can be an important function of ISCs – 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. 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 upon both investment promotion (attraction of new investment) and investment facilitation (finding partners for prospective investors in the pre-establishment phase).

Other support services required from IPAs and ISCs include:

- On-going trouble-shooting:
  - With utilities on regulatory matters – customs clearance, taxation, immigration etc.;
  - Resolving inconsistencies of local procedures with the 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 associations.

- 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;

A true investment facilitation job is navigating the bureaucracy and acting as a “one-stop” shop (OSS) to get all required permits and licences for the investor. 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 10.6).



### 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 licences, permits, approvals and clearances. Without such an all-embracing authority, the agency could not, in fact, wield much control over the process, having to depend on other authorities.

In practice, however, such an idealistic notion of the OSS has proven unrealistic. Practically all Governments that have 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. Such a mirroring of administrative capabilities would turn an OSS into a bureaucratic super-agency with massive staff and resource requirements, unlikely to provide 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 is 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) noted 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

IPAs worldwide are increasingly trying to provide OSS facilities with varying degrees of success. It is important that OSSs provide quick and efficient (digital) assistance to investors in sorting out the requirements and issues listed. This means that IPAs should pro-actively identify immediate and future needs, in particular in the areas of infrastructure, manpower, support services and customs services, and feed the information to respective agencies to ensure their immediate response to address investor needs. Digital OSS also increase the transparency of registration processes, reducing local corruption and

increasing investor confidence. Best practice OSSs are difficult to find. In the Asia-Pacific region, however the services of Invest in Taiwan Province of China (<http://investtaiwan.nat.gov.tw/eng/show.jsp?ID=223>) 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. Boxes 10.7 and 10.8 describe the services of the recent one-stop (one-door) service centre of BKPM Indonesia and a digital OSS developed in Bangladesh.



**Box  
10.7**

### **One-Stop Service Centre of BKPM Indonesia**

Badan Koordinasi Penanaman Modal (BKPM) is the Investment Coordinating Board of the Republic of Indonesia. Restored to ministerial status in 2009, as a primary interface between business and the Government, reporting directly to the President of the Republic of Indonesia, its goal is not only to seek more domestic and foreign investment through a conducive investment climate, but also seek quality investments that improve social inequality and reduce unemployment.

In January 2015, BKPM launched the integrated one-stop service centre (PTSP) to facilitate better coordination among related parties at the national level, and to create a business-friendly bureaucracy by reducing processing time, synchronize procedures, avoiding overlap and eliminating costly red tape for entrepreneurs and investors. With PTSP, investors will not need to visit various ministries or government agencies to obtain the necessary permits, and can have investment licences processed in one system. While similar one-stop services existed before, this is the first time a fully-integrated service is provided.

The BKPM one-stop service is supported by 22 ministries and government institutions that were previously run separately with each institution posting an official at the PTSP. Moreover, since the implementation of technology-based business licensing system Online Single Submission (OSS) System in 2018, PTSP has also been available to help clarify the procedure of business licensing applications through the OSS system. Furthermore, in 2021, an investment licensing service was introduced. To qualify, investors have to invest a minimum of IDR100 million (US\$7.33 million) and/or employ a minimum of 1,000 staff.

The investment licensing service for foreign investors includes the issuance of an investment licence, a 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 a letter on land availability. The service employs 77 liaison officers from the 22 ministries/government agencies. The front desk liaison officers accept documents and give consultations with 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 licence applications and to make sure that the deadline completion is in accordance with set operating procedures. To facilitate obtaining information and filing complaints, BKPM provides a telephone contact centre that operates 24 hours, seven days a week.

*Source:* Available at <https://www5.bkpm.go.id>



### Digital one-stop services in Bangladesh

The Bangladesh Investment Development Agency (BIDA) has introduced a one-stop service digital tool that enables domestic as well as international investors to submit regulatory documents at a single location and agency. The Bangladesh Economic Zones Authority (BEZA) initiated the “One-Stop Service Act 2017” to increase attractiveness for foreign investments.

Under this act, BIDA has been given the authority to implement the One-Stop Service Platform or “One-Stop Shop” (OSS) where a One-Stop Service personal ID (OSSPID) can easily be requested for prospective investors and businesses. Besides regulatory services from BIDA, the OSS facilitates the approval of permits and certifications from the Bangladesh Export Processing Zones Authority, the Bangladesh Hi-Tech Park Authority and BEZA. Together, these agencies provide 31 services using the OSS to ensure their delivery from a single digital point to investors; an end-to-end digital application process.

The creation of the digital OSS has increased the quality of the services provided to investors and has improved, particularly during the COVID-19 pandemic.

Source: <https://bidaquickserv.org/articles/one-stop-service>

## D. Post-establishment investment facilitation: Aftercare

### 1. Rationale for aftercare

Aftercare comprises all potential services offered at the company level by IPAs, designed to (a) facilitate both the successful start-up and continuing development of a foreign affiliate aiming at maximizing its contribution to local economic development, and (b) ensuring the success and sustainability of the company’s investment (Young and Hood, 1994; VCC, 2009). It is “the range of activities from post-establishment facilitation services through to developmental support to retain investment, encourage follow-up on investment and achieve greater local economic impact” (UNCTAD, 2007). Thus, it can be understood as the investment promotion equivalent of customer care and relates to proactive management of existing investors. It plays an important role in investment retention and investor development, proactively helping investors to grow. Investment retention is a short-term concern based on the perception that a significant share of FDI is actually re-investments. It has become particularly important in the wake of the COVID-19 pandemic and sharp drops in FDI globally. Investor development takes a long-term strategic view that growth of existing investment will ultimately lead to more jobs and economic growth for the host economy.

The principal purpose of aftercare is to build investor confidence, trust, and loyalty. The idea is to create

customers (investors) who display such a high level of satisfaction and loyalty that they not only re-invest, but also serve as ambassadors for the host country/location and a principal marketing tool for the IPA.

Given recent trends in the world economy and in FDI, IPAs have had, and must continue, to adopt a much stronger focus on aftercare and supply chain development during the pandemic. In the first months of the COVID-19 pandemic, IPAs around the world increased their aftercare focus and more than half of IPAs created a full aftercare division (figure 10.1). Aftercare services have become focused on supply chain programmes, with more IPAs providing services in that area. IPAs have also moved into providing facilitation and aftercare services digitally, with a near-tripling of IPAs switching to digital services for investors (figure 10.2). Thus, it can be expected that these three trends (enhanced focus on aftercare, supply chain linkages and digital services) will be permanent changes in investment promotion and facilitation strategies.

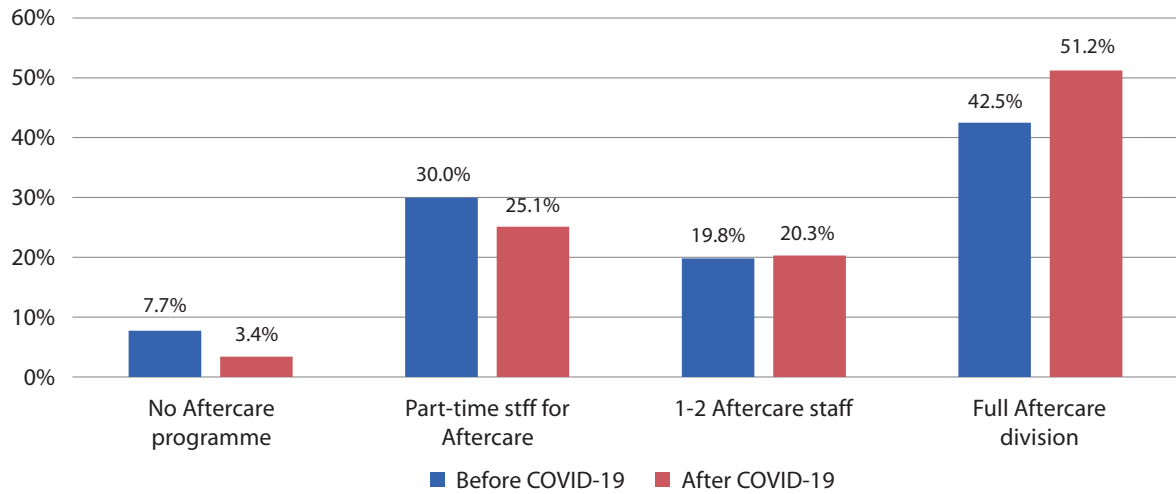
The principal rationale for aftercare can be summarized by the C.R.E.E.D. principle:<sup>1</sup>

- 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.

<sup>1</sup> Available at <https://prezi.com/mpixn0dfthis/how-to-develop-after-care>.

**Figure 10.1**

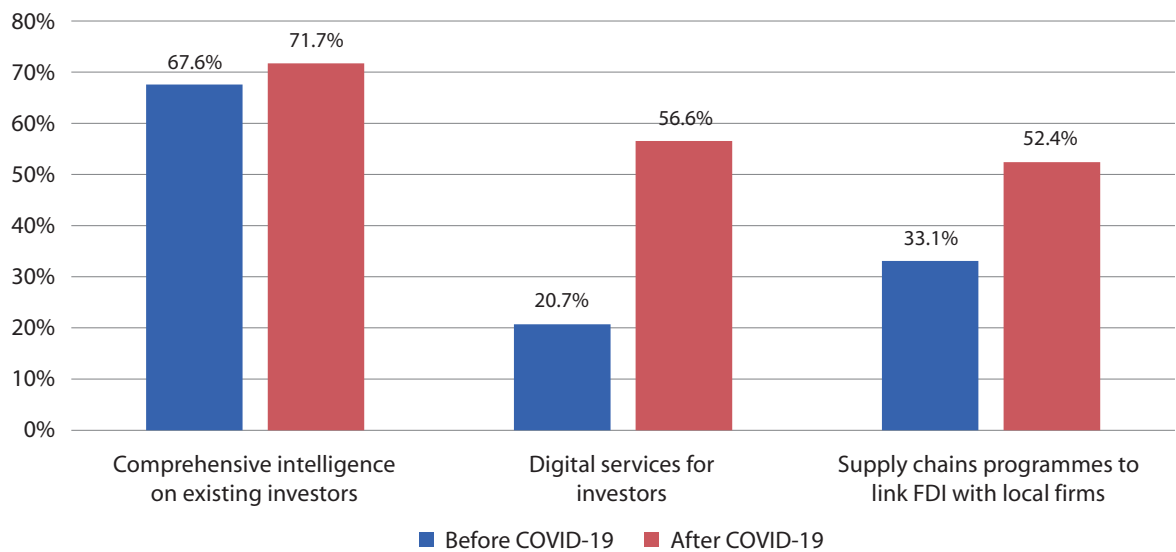
**Aftercare/Business Retention (BRE) programmes before and after COVID-19 (per cent of IPAs)**



Source: Wavteq webinar poll, 30 April 2020 (207 IPA respondents).

**Figure 10.2**

**Aftercare activities of IPAs (per cent of IPAs)**



Source: Wavteq webinar poll, 30 April 2020 (207 IPA respondents).



### BOI Philippines Strategic Investor Aftercare Programme (SIAP)

In ensuring sustained interface with its registered investors and creating opportunities for businesses to grow in the Philippines, the BOI established the Strategic Investors Aftercare Programme (SIAP) in early 2008. The SIAP is a proactive programme that aims to create a high quality, trust-based working relationship with strategically important existing (foreign-) investors in order to ensure continuing business in the country. The programme is conducted by the Strategic Investors Aftercare Division (SIAD). The Investment Climate Advisory Services team of the World Bank Group provided support during the design phase.

#### Objectives

- Establish lasting partnerships and foster effective and sustained interaction with 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 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

- Immediate resolutions to issues raised by investors pertaining to their business concerns;
- Establishes valuable business contacts, investors are linked up with proper authorities, and facilitation of 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 government agencies that signed a Memorandum of Agreement (MoA) to sustain government efforts to provide resolution on all investment-related transactions concerns via prompt actions, streamlining procedures and establishing coordination among its members. Originally, the IPU Net MoA was a commitment by 27 government agencies. Due to the large increase in investment over the last decade, the MOA's now 37 departments and government agencies, all committed to stronger collaboration to further improve the ease of doing business and competitiveness in attracting investments. 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 IPU Net member agencies are acted upon by the Office of the Ombudsman (OMB).

In 2018, the SIAP received a 96.5% satisfaction rating from 42 companies it had visited.<sup>2</sup> In these regular visits to registered companies, the BOI through SIAP provides investors with updates on investment policies and sector developments, and conducts an interactive client feedback mechanism by encouraging investor's participation through feedback and suggestions.

*Source:* Invest Philippines. Available at <https://boi.gov.ph/investor-aftercare-services/> as well as <https://boi.gov.ph/ipu-net-moa-signing-among-government-agencies-to-take-place-on-july-10/> and <https://boi.gov.ph/boi-eyes-more-investments-with-ipunet-moa-signing/>

<sup>2</sup> Manila Times, 12 September 2014. Available at <https://boi.gov.ph/boi-reaps-positive-feedback-from-investors/>

Apart from the business case for aftercare services, there is a clear economic development case for aftercare (partly based on UNCTAD, 2007):

- **Short-term benefits:**
  - Support investors in realizing their initial investment plans;
  - Existing investors are a “captive audience” – generally quicker and easier to attract new investment from them. “It is seven times more expensive to land a new customer than it is to sell to an existing one.” (World Bank/MIGA, 2000);
  - The satisfied TNC will do the marketing for the IPA, and can act as an investor ambassador for the host country.
- **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 upgrading 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;
  - Prevention of investor-state disputes.
- **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

Effective delivery of aftercare requires a thorough understanding by the IPA and its designated account executive of investors and their strategic plan for expansion. A structured aftercare service includes administrative, operational and strategic support to MNCs. Below is a non-exhaustive overview of services related to the three different categories of aftercare (UNCTAD, 2007 and 2008):

- Administrative services facilitate the operations of foreign firms. These include: obtaining permits and permission 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;

- 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.

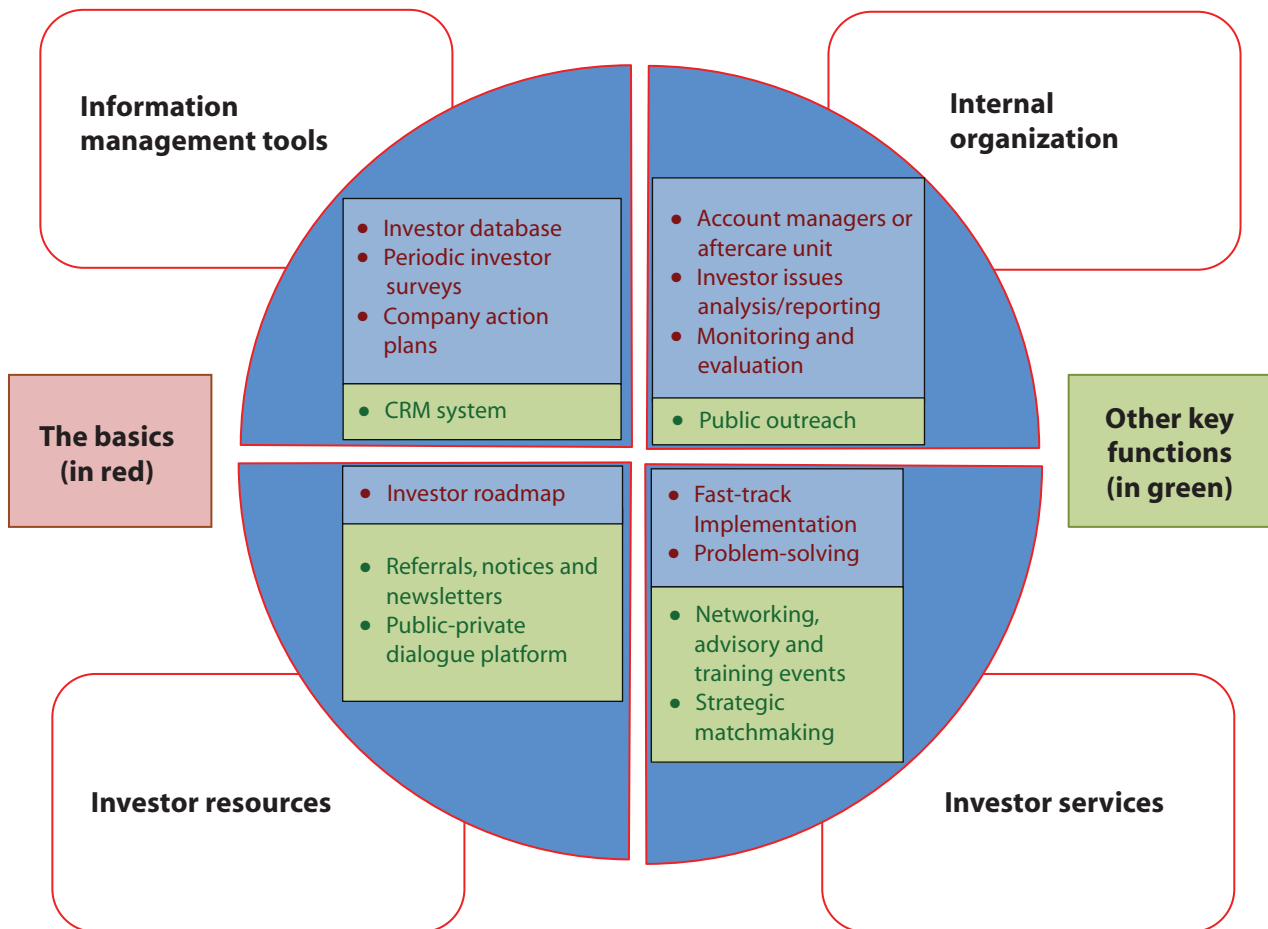
If an IPA does not yet have a fully established Aftercare Department, it should begin by providing administrative aftercare services first. Over time, the IPA would be able to develop its capacity to service investors with operational and strategic aftercare services. Figure 10.3 illustrates an integrated system for providing aftercare services. It shows the importance of four main components: information management and monitoring; internal organization; investor resources; and investor services.

There are a number of minimum requirements for effective and sustainable aftercare, including:

- 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;
  - Maintaining 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 intermediary between public and private entities.
- Organizational:
  - Sufficient number and level of dedicated staff to aftercare;
  - Ombudsman function;
  - Sufficient authority;
  - Sufficient resources.



Elements of a full investor aftercare system



Source: Investment Consulting Associates.

It is important to note that countries often want to stimulate economic growth away from major urban cities, into the provinces and less developed areas. As a result, FDI is often promoted in those areas that are, by definition, less attractive to investors due to a less 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 licences 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, while in other cases local IPAs need to design their own programme as the conditions of one locality may differ from others, and investors need tailor-made aftercare programmes. Even worse is that 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. 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 requires 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. 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;



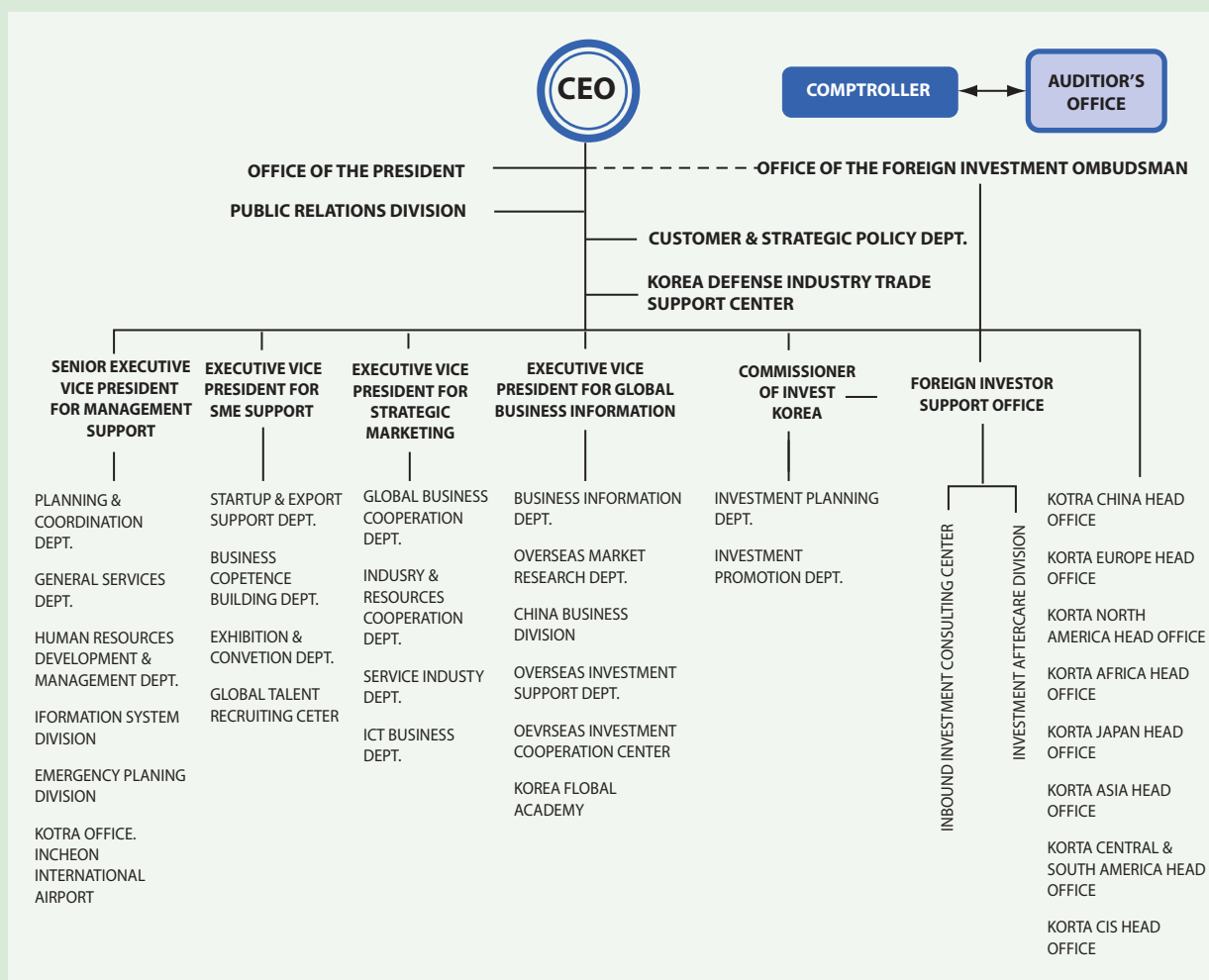


**Best practice in aftercare: Republic of Korea**

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 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 to the Korea Trade-Investment Promotion Agency (KOTRA). Invest KOREA is the Republic of Korea’s national investment promotion agency mandated to support the establishment of foreign business in the Republic of Korea, while the OFIO was established to provide investment aftercare services and grievance resolution services for foreign investors and foreign-invested companies in the Republic of Korea (KOTRA, 2020).

Directly commissioned by the President of the Republic of Korea, the OFIO works through close cooperation with experts, also called “home doctors”, who have deep expertise and knowledge in their respective fields (finance, accounting, legal affairs, labour, environment, etc). OFIO works as well with investment cooperation officers dispatched from the central and local governments. They conduct activities including: preventing and resolving grievances of foreign-invested companies; on-site visits to mother companies; offering advice on overall business management; proposing system improvements to government ministries; and requesting coordination between relevant government organizations in administrative procedures. Figure A shows the role of aftercare in the institutional framework for investment promotion and facilitation in the Republic of Korea.

**Figure A. The role of aftercare in the institutional framework for investment in the Republic of Korea**



Source: KOTRA, e-brochure. Available at [https://www.kotra.or.kr/foreign/kotra/KHENKT180M.html?TOP\\_MENU\\_CD=KOTRA](https://www.kotra.or.kr/foreign/kotra/KHENKT180M.html?TOP_MENU_CD=KOTRA)

**Box 10.10** (continued)

The OFIO system has been widely recognized by foreign-invested companies in ROK and are highly regarded by international organizations including the World Bank, WTO and UNCTAD as a best practice for providing aftercare services to foreign investors (KOTRA, 2020). For example, UNCTAD has awarded KOTRA the 2006 World Association of Investment Promotion Agencies (WAIPA) trophy for excellence in the establishment of OFIO system (Ahn, 2008).

According to KOTRA (2020), reinvestment accounts, on average, for nearly half of the total FDI inflows. Examining the Republic of Korea's performance in attracting FDIs over the past five years, reinvestment has accounted for 45% on average on notification basis, and this number increased to 57% on average on arrival basis. This has raised the significance of reinvestment attraction, which includes providing investment aftercare services to existing foreign-invested companies. In 2019, the OFIO helped to improve the investment environment by resolving a total of 332 grievances from foreign-invested companies operating in the Republic of Korea. As a result, the OFIO contributed to attracting US\$534 million reinvestment on notification basis, accounting for 5.6% in total reinvestment on notification basis (US\$9.52 billion).

Some examples of reinvestment resulting from the support of the OFIO in 2020 are listed in table 10.4.



**Table 10.4** Selected cases of reinvestment attraction through grievance resolution in the Republic of Korea, 2020

Company name (parent company's location)	Business Type	Notified reinvestment (US\$)	Grievances
Ikea Korea (Sweden)	Wholesale/retail (distribution)	259 million	Request for detailed guidelines for a mutually constructive relationship with local communities.
Toray Battery Separator Film Korea (Japan)	Electrical/electronics	110 million	Legislation proposal on conducting external audit of LLCs.
Dongwoo Fine-chem (Japan)	Chemical engineering	40 million	Applying for changes to the individual-type Foreign Investment Zone due to reinvestment
Umicore Materials Korea (Luxembourg)	Electrical/electronics	35 million	Request for support regarding delays in installing power grids.

Sources: Ahn (2008); KOTRA (2018 and 2020).

- Convergence or complementarity of national and local laws, rules and regulations;
- Understanding 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);
- Other issues requiring division of labour between the national and local IPAs;
- Government-investor dialogue and consultation mechanisms (at the national and local levels).

Apart from coordination among national and local IPAs and other involved agencies, there are a number of other challenges to the effective delivery of aftercare services as identified by UNCTAD (2007 and 2008), such as institutional credibility and reputation, capability and competency of staff, pro-active and suitable yet not clingy support, continuity and responsiveness. These generally correspond with the overall challenges for IPAs as mentioned above.

## E. Discussion issues

1. What is your investment realization rate compared to the 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 within 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 licences etc.? Are services available to investors online? Which ones?
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? Is it online? If not, should you have one? If yes, how would you rate its performance?
7. How effective is your IPA 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?
13. Have you considered digitalizing your aftercare services?
14. How have your aftercare services changed, or will they change, due to Covid-19?
15. Is your country involved in the investment facilitation for development discussions at the WTO? What measures has your country introduced?



## CHAPTER



# Planning, monitoring, and evaluating an Investment Promotion Agency's performance<sup>1</sup>

This chapter covers some approaches that can be used to monitor and evaluate an IPA's activities internally (from an organizational perspective) as well as externally (the results achieved in terms of investor attraction and facilitation).

## A. Definitions and purpose of planning, monitoring and evaluation

Monitoring and evaluation (M&E) can help an organization to extract relevant information from past and ongoing activities for fine-tuning, reorientation, and future planning of activities and modalities. 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 them more effectively and efficiently. M&E is very closely linked to planning. While various definitions of planning, monitoring

<sup>1</sup> The M&E of an IPA performance is strongly linked to the M&E of individual investment projects although the key performance indicators are quite different. Nevertheless, an IPA's performance is often, and obviously, linked to the performance of the investment they managed to attract.

and evaluation exist, the most useful ones are arguably 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 them;
- Determining and allocating the resources (financial and other) required;
- Outlining implementation arrangements, which include arrangements for M&E progress towards achieving the targets.

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.” Therefore, monitoring refers to the progress made towards achieving a goal and allows for corrective actions if it is found that progress is below expectation or lagging, given that the stipulated time period within a goal needs to be achieved.

UNDP (2009) defines evaluation as “a rigorous and independent assessment either of 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 was the process.” 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, individual staff performance and goals of the IPA, such as the amount of targeted FDI or number of MNCs in target sectors attracted and projects

implemented. The 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.

The main purposes of the M&E of an IPA are presented in table 11.1. Recently the OECD also published a brief guide on effective monitoring and evaluation of IPAs (OECD, 2019; available at <https://www.oecd.org/investment/Monitoring-and-evaluation-a-brief-guide-for-investment-promotion-agencies.pdf>).

In addition to its essential role in allowing policies to be adjusted, other benefits of an effective M&E system are that:

- It provides information to the public and business sectors;
- It helps to apply information to promotional campaigns;
- It demonstrates that public funding is being put to good use (based on an IPA’s documented achievements) and increases transparency;
- It helps benchmarking the IPA against others.

The 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 story and may not reflect the true opinion of investors, as they will be careful not to upset their host country. An effective M&E system 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 motivation 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 an IPA is externally funded, either from national government resources or from overseas donors, funding agencies would like to know how effectively their resources were used in achieving the stated objective. In order to obtain an objective assessment, a meaningful evaluation should be conducted by an external specialized agency.


**Main purposes of M&E of IPAs**

Purpose	Modalities and requirements
1. Improving the IPA's services for investors.	<ul style="list-style-type: none"> <li>● Feedback from investors about the quality of IPA's services;</li> <li>● Feedback from investors about additional services desired from the IPA;</li> <li>● Setting higher standards for the length of time required to complete various types of services for investors;</li> <li>● Appropriate number of staff members to provide services to investors:                             <ul style="list-style-type: none"> <li>– Often a lack of account executives/case officers is a major constraint.</li> </ul> </li> </ul>
2. Strengthening the capacity of the IPA.	<ul style="list-style-type: none"> <li>● Much of the feedback from investors about the quality of services can help to identify areas for training of IPA staff;</li> <li>● Annual performance reviews of IPA staff also indicate human resource development requirements;</li> <li>● High-level IPA management training in specific areas.</li> </ul>
3. Setting targets and goals for the IPA's investment promotion strategy.	<ul style="list-style-type: none"> <li>● Compare actual outcomes from investment promotion activities with the original targets and goals:                             <ul style="list-style-type: none"> <li>– Have you achieved them? If not, can you determine why? Shortcomings of the IPA? Global or regional factors beyond your control?</li> </ul> </li> <li>● Revise annual or long-term goals and targets:                             <ul style="list-style-type: none"> <li>– Make them more realistic or set more ambitious goals, depending on the outcomes of the evaluation.</li> </ul> </li> <li>● Make adjustments to the IPA's strategies and projects to achieve the desired results.</li> </ul>
4. Accountability of the IPA.	<ul style="list-style-type: none"> <li>● 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.</li> <li>● IPAs are under increasing pressure to demonstrate impact, efficiency and effectiveness, heightening the role of monitoring and evaluation.</li> </ul>
5. Improving the local investment environment.	<ul style="list-style-type: none"> <li>● Major complaints or problems commonly encountered by investors indicate key areas in the investment environment in need of improvement:                             <ul style="list-style-type: none"> <li>– Determine which are within your mandate and which ones need to be addressed by other agencies.</li> </ul> </li> <li>● Findings from IPA's own evaluation can identify factors restricting the benefits from investment or insights on what works well:                             <ul style="list-style-type: none"> <li>– What were the causes of the IPA not achieving its goals? Some may lie in the overall environment and not within the IPA;</li> <li>– What were the success factors if the IPA surpassed its goals? Can these be strengthened to bring about even greater benefits?</li> </ul> </li> </ul>

Sources: ICA/ESCAP; Loewendahl (2001).

## B. Evaluating an Investment Promotion Agency's performance: A closer look

Broadly, four phases of evaluation can be distinguished as presented in figure 11.1. In addition, there are three broad types of evaluation that incorporate these phases.

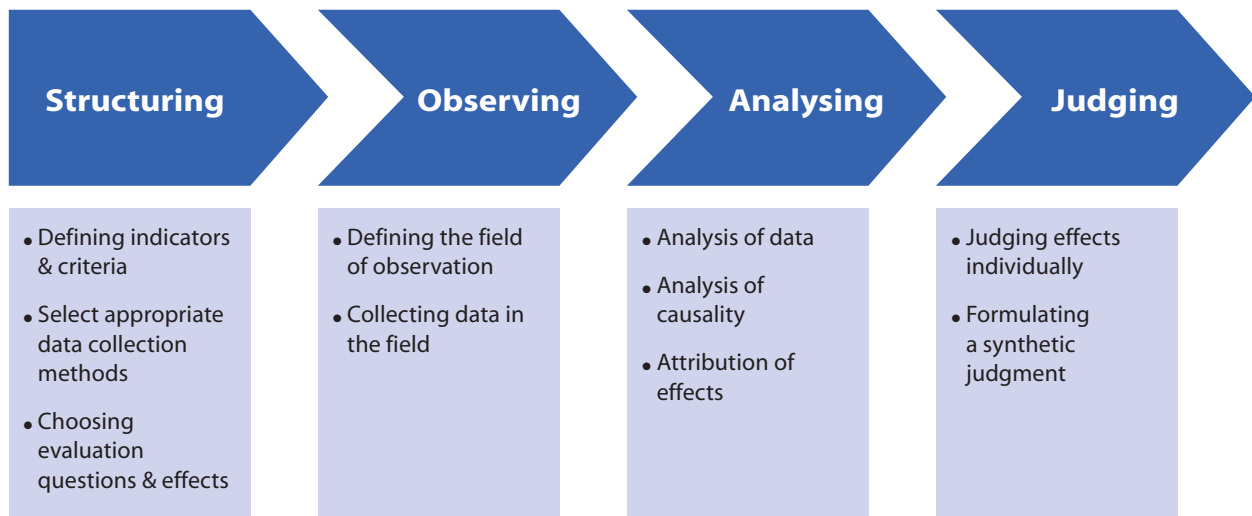
Ex-ante evaluation, also known as programme design review, is a type of evaluation used **before** a programme is actually implemented in order to review its design and help prepare a finalized project plan.

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 can be used to evaluate:

- 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;



Four phases of evaluation



Source: Investment Consulting Associates.

- 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.

A 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 determining 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 cannot succeed under any circumstances and should therefore 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 can basically be seen as synonymous to monitoring. Process evaluation will help the IPA to 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:

- 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 carried out.

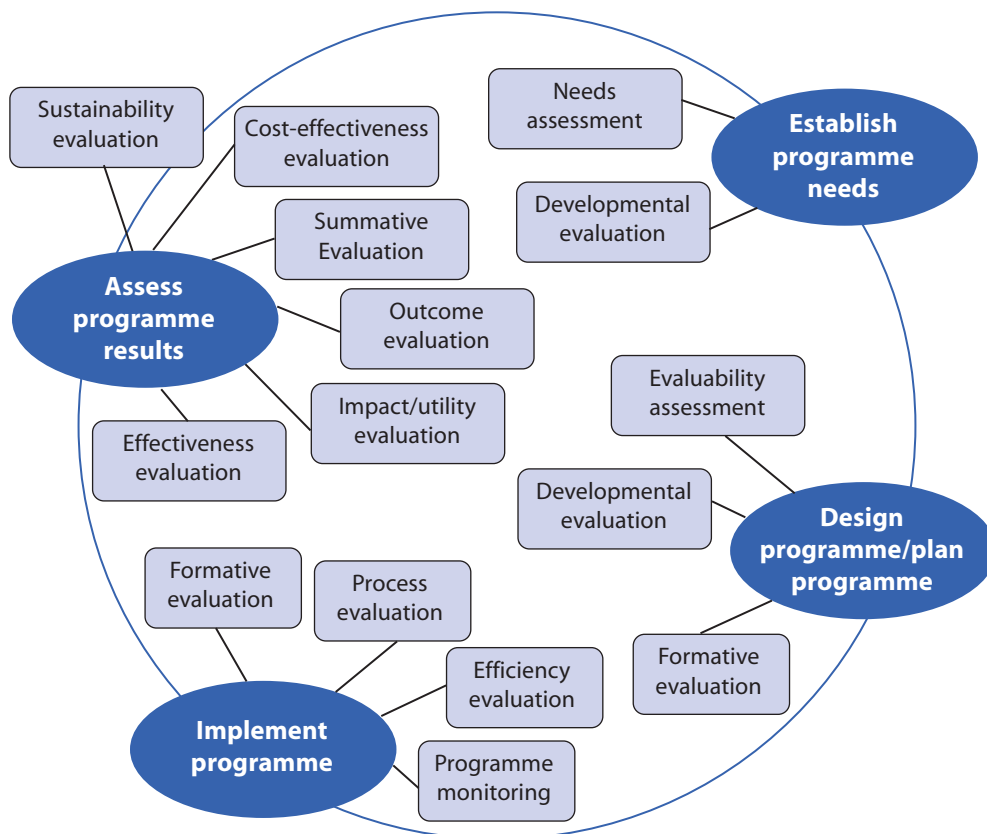
Ex-post evaluation or summative evaluation refers to looking back at a completed (or terminated) programme to determine its impact, how well it was carried out, how efficiently the resources were used, understanding the logic between interventions and outcomes, and providing insights for subsequent phases of the project or new ones. Ex-post evaluation includes both outcome evaluation and impact evaluation. While the former measures the IPA's progress toward achieving its goals and objectives against a baseline, the latter measures the long-term, and intended and unintended programme effects.

Based on the above definitions, typology and descriptions, the interlinkages between planning, monitoring and evaluation can be elaborated in a cycle as presented in figure 11.2. 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



**Figure 11.2**

**The planning, monitoring and evaluation cycle**



Source: ESCAP, 2017.

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. Developmental evaluation is essentially the same as formative evaluation, although 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 can determine whether or not it was successful, and by what criteria.

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 the IPA's overall performance), as mentioned above. 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) – measuring change in the observed output or outcome; attributing observed changes or progress toward changes to the initiative (project evaluation) or determining the IPA's contributions toward observed changes; and judging the value of the change (positive or negative).

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 that 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 IPA's credibility, an external evaluation by independent outside evaluators is also important and the IPA needs to budget for that exercise (box 11.1).

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, 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



Box  
11.1

### 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 in collaboration with national experts from partner countries.
- **Credibility:** The evaluation team must be able to draw on the necessary (or required) methodological and subject-related knowledge as well as social skills. The methods applied in the evaluation and its findings must be presented clearly in the reports.
- **Participation:** Evaluation is designed as a process: External expertise and assessment is combined with a critical discussion by the project stakeholders (i.e., investors) and target population to gain new perspectives and reach agreement on future work.
- **Transparency:** The subject, purpose, scope, addresses, evaluation questions, methods, schedule, qualifications of the evaluation team, reporting and coordination must be clearly defined in the terms of reference for the evaluation.
- **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. To account for current developments, the ADA is pursuing new methods and approaches in evaluation. Evaluations will be carried out increasingly with other donors in the future. Added to this is the great challenge of propagating and institutionalising evaluation findings, because this is the only way to ensure these find their way into both policy dialogue and development cooperation practice.

Source: Austrian Development Agency. See <http://www.entwicklung.at/en/ada/evaluation>

could be either quantitative (e.g., the number of investment projects, attracted capital, created jobs and tax revenues) or qualitative (e.g., priority or strategic types of industries and companies attracted, and 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 for evaluating the efficiency of activities and services provided by IPAs is the period in which IPAs are able to respond to individual requests. Based on the IPA life cycle of activities and functions, a number of indicators have been developed to measure the performance of IPAs based on the four key functions of an IPA. Table 11.2 lists some possible performance indicators for each phase, while table 11.3 lists some specific indicators to review the marketing activities of an IPA, which can be used to 'tick' boxes while reviewing an IPA website upon completeness of information.



**Table 11.2** KPIs based on an IPA's promotion life cycle

Activities	Input	KPI-Indicator	Year 1			Year 2		
			Current	Target	Actual	Current	Target	Actual
Image Building & Marketing Strategy	Target sectors & markets	Defined and agreed						
	Value proposition per target sector & market	Defined and agreed						
	<b>Position Location A</b>							
	Media mentions of Location A as investment location	Monthly number						
	Media mentions of Location A as lead investment promotion agency	Monthly number						
	Location A as investment location (unprompted)	Monthly number						
	Location A as investment location (prompted)	Monthly number						
	Investor's perception of location	Score between 1-10						
	<b>Ads &amp; Advertorials</b>							
	Newspaper	Monthly number						
	Magazines	Monthly number						
	Television	Monthly number						
	Radio	Monthly number						
	Direct Mail/Newsletter	Monthly number						
	<b>Website</b>							
	Website hits	Monthly number						
	Web queries/contacts	Monthly number						
	Page hits	Monthly number						
	Content downloads	Monthly number						
	<b>Social Media</b>							
	LinkedIn Company Page	Nr. of followers/likes/comments						
	Twitter Account	Nr. of followers/likes/retweets						
	YouTube Account	Nr. of subscribers						
	YouTube Account	Nr. of aggregate views						
	Facebook Page	Nr. of links/comments						
	Facebook Page	Nr. of followers						
	<b>Public Relation</b>							
	Media briefings given	Quarterly number						
	Advertorials placed	Quarterly number						
	Press releases	Quarterly number						
	<b>Events</b>							
	Regional/local seminars/conferences organized	Annual number						
	Regional/local seminars/conferences organized	Annual number						
International seminars/conferences organized	Annual number							
International seminars/conferences organized	Annual number							

Table 11.2 (continued)

Activities	Input	KPI-Indicator	Year 1	Year 2	
			Current	Target	Actual
	<b>(Digital) Materials</b>				
	Digital & printed brochures per sector/marketing including value proposition	Within first month			
	Monitoring	Monthly			
	Maintenance	Monthly			
<b>Investor Targeting &amp; Lead Generation</b>	Database & maintenance	Annual number			
	Accountmanagers and follow up	Annual number			
	Inquiries received	Monthly number			
	Investors proactively contacted	Monthly number			
	Leads generated/meetings held	Monthly number			
	Investment prospects	Monthly number			
	Investor visits handled	Monthly number			
	Investor Enquiries	Hours/Days			
	Sources of leads (event, mailing, advertisement, etc.)	Indicate			
<b>Investor Servicing Facilitation</b>	FDI projects that have been attracted	Annual number			
	Value of investment projects	Number in US\$			
	Jobs created	Number			
	Type of investment (e.g. headquarter, R&D, warehouse, etc.)	Scoring indicator			
	Increase in tax revenue	Number in US\$			
	Per capital income growth	%			
	Investor enquiries and site visit follow up	Number			
	Response time	Hours/Days			
	Quality of response	Score between 1-10			
	<b>Quality of investment projects</b>				
	Is the project in line with the SDGs?	Develop measurement indicators			
	Successful linkages with domestic companies	Yes/No			
	National and/or provincial growth rates	%			
	Sector agrowth rates	%			
	Quality of investments (e.g. moving up the value chain)	Score between 1-10			
	New spin off industries	Yes/No			
<b>Aftercare &amp; Policy Advocacy</b>	Conversion rates of...				
	– Contacts becoming leads;	Number			
	– Leads making site visits;	Number			
	– Site visitors becoming investors.	Number			
	Investors' rating of IPA's services	Between 1-10			
	Retention and expansion rates of investment projects	Number			
	Contact existing investors for expansion	Percentage per annum			
	Support local companies in attracting investors	Annual number			
	Organize brainstorm sessions with private sector and government	Annual number			
	Initiate co-operation with other ministries (stakeholders)	Yes/No			
	Advise on doing business in sessions	Annual number			
	Policy or regulatory improvements in the investment environment	Number			
	Recommendations to Ministry about improvement of investment climate	Yes/No			

Source: van den Berghe, 2019.


**Template and criteria to review an IPAs marketing and website**

Name	IPA	Features	Comments	Actions
Domain name				
Logo				
Website	Domain name			
	Languages	English, other languages	Website language determined by visitor's IP address?	
	Users, audience	Investors, Intermediaries, Media		
1. Landing page	Name and logo		Matching brand	
	IPA brand style		Matching brand	
	Tag line		Moving forward	
	Visual navigation		Clear navigation: horizontal bars, left to right	
	Languages	National language, English and other foreign languages symbolised by flags		Default language settings in English or other language determined by visitor's IP address
	Image heavy		Aerial photos, infrastructure, tourism, logistics, free zone in slider	
	Appearance		Clean and fresh	
	GPS coordinates associated to navigation maritime sector		Links to tag line: moving forward	
	Social media	LinkedIn, Twitter, Facebook, YouTube		1. Add social media widgets to top navigation bar. 2. Add Twitter feed to landing page.
	Recent updates	Newsfeed markets		Replace by relevant news for investors
		Recent updates include upcoming and past events (downloadable PDF)		1. Add contact details and link to events. 2. Enhance event's theme, date and place
	Investment sectors			Enhance visually
				Rename investment opportunities
		For example: Tourism, financial services, oil refinery and renewable energy, information technology, logistics, trade and distribution, manufacturing, cultural and creative		Investment opportunities include tourism, financial services, oil refinery and renewable energy, information technology, logistics, trade and distribution, manufacturing, cultural and creative
	Transnational Education and Economic Zones		Transnational, Education and Economic Zones are strengths of country and need to be featured/highlighted separately.	
News		Latest news update		
Events		Upcoming events		
Contact		Mail to: info@... and a telephone number (available 24/7).		

**Table 11.3** (continued)

Name	IPA	Features	Comments	Actions
		Subscribe to newsletter	Form to enter name and email address	
		Tabs (to pages)	Home, About Us, Team, Partners, Investors, Media, Contact	
	2. Home	Landing Page	See above	
	3. About us	Profile		
		Mission		
		Services		
		Background		
	4. Team (bio and photo)	Board Members		
		CEO/Chairman		
		Sales and Marketing Manager		
		Account Managers		
	5. Partners	Partner organizations' logo linking to URL and text.	e.g., other Free Zones	
	6. Companies operation in country	Logo, URL and name and credentials		
	7. Media	(News) Articles		
		Press Releases		
		Newsletters (imported from, e.g., MailChimp)		
		Videos (site visits, interviews)		
		Podcasts		
		Photos		
	Resources	Links to websites of relevant organisations/information providers		
		Articles, Reports, White Papers (downloadable)		
		Presentations (downloadable)		
	Contact	Company Information and contact details	<a href="https://www.google.nl/maps/">https://www.google.nl/maps/</a>	

Source: van den Berghe, 2018.

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) and project description.
3. Location and sector information: Location of the investment down to site address and 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 and 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 (2008) comprehensive paper on evaluating IPAs deals with tools of evaluation in more detail can be accessed at [http://unctad.org/en/docs/diaepcb20082\\_en.pdf](http://unctad.org/en/docs/diaepcb20082_en.pdf).

Collecting data and information for a successful evaluation is always a challenge. IPAs can use surveys and interviews to assess client satisfaction

and obtain primary data, while secondary data can be obtained from international chambers operating in a country as well as from articles in international business and economic journals, for example. Table 11.4 shows the data and information used for evaluation.

In terms of enhancing the quality of FDI data and statistics, some new approaches, apart from the role international organizations (like OECD, UNCTAD and IMF) play, have been developed recently. For example, Loewendahl (2016a and 2016b) provides suggestions to IPAs and EDOs on how to improve their FDI accounting measurements based on greenfield FDI data. (See also Wavteq's investment map at <https://www.wavteq.com/systems/wavteq-investmentmap>).



**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 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  
11.2**

### Best practice M&E of an IPA: Costa Rica

Despite its small size, Costa Rica's IPA (CINDE) invests heavily in monitoring and evaluation (M&E) activities, partly due to direct top management support that sees it as a critical strategic decision-making tool. In fact, CINDE ranked second place in the IPA Evaluation Index (Sztajerowska, 2019). The IPA Evaluation Index captures the extent of IPA's overall engagement in M&E activities and allows for comparisons across countries. This index looks at institutional arrangements for M&E activities, array and sophistication of M&E techniques, and tools used as well as the coverage of the agency's CRM, among others, to capture the differences in M&E approaches.

To that extent, CINDE carries out multiple activities that primarily aim at supporting foreign investors in gathering specific information on local business conditions, the installation process and additional services. These can include: attendance and organization of events such as sectoral fairs, exhibitions and missions in Costa Rica and abroad, and bilateral meetings with potential investors; reply to specific inquiries including analysis of raw data and production of market studies; tailored Gantt charts together with a detailed explanation of the sector-specific installation process; and simulations of expected profits and losses for concrete business in Costa Rica.

A recent academic article (Volpe Martincus and others, 2020) shows that the type of services CINDE provides to foreign investors helps them overcome information barriers. The study shows the assistance from CINDE has had a significant positive impact on the probability that MNEs establish a first affiliate in Costa Rica. These effects seem to be even larger for countries and sectors facing higher information barriers, such as countries not sharing a common language with Costa Rica and sectors producing differentiated goods and services.

Throughout CINDE's almost 40 years of innovation, high-quality services and operative excellency, it has generated more than 90,000 direct high-quality and well-remunerated jobs as well as attracted more than 300 multinational companies that daily export goods and services globally that are of the highest quality. The results are clear – the many M&E activities by CINDE are paying off.

*Sources:* Sztajerowska, 2019; Volpe Martincus and others, 2020; and CINDE, <https://www.cinde.org/en/essential-news/costa-rica-has-the-best-qualified-investment-promotion-agency-in-the-world>



**Box  
11.3**

### Best practice M&E of an IPA: Dubai

Dubai FDI is the IPA for Dubai and is part of the Department of Economic Development of the Government of Dubai. It was the first IPA in the world to publish real-time FDI data utilizing innovative, cost-effective techniques and thereby promoting Dubai more effectively to foreign investors. In 2015, Dubai FDI decided to systematically track FDI into Dubai with four key objectives:

1. Understanding the role of FDI in the Dubai economy and, through the collection of FDI data, informing the investment promotion strategy of Dubai FDI;
2. Promoting Dubai more effectively to potential foreign investors through the launch of "Dubai FDI Monitor LIVE", which is an online portal for real-time FDI data on Dubai with GIS mapping tools ([www.dubaifdimonitor.ae](http://www.dubaifdimonitor.ae));
3. Creating greater awareness among key stakeholders in Dubai of FDI's importance, its impact on the Dubai economy and raising the visibility of Dubai FDI;
4. Engaging directly with companies investing in Dubai to ensure their investments take place, and provide investment aftercare services as needed by investors.

To implement the initiative, Dubai FDI created a public-private partnership to draw on the technology and expertise of private sector FDI specialists, and to enable the project to be implemented cost-effectively and within a short timeframe. Through the partnership, Dubai FDI systematically records daily FDI taking place in Dubai and measures its economic impact, including its technology intensiveness, a key indicator of economic development.

The project also provides resources to identify companies investing in Dubai, to research and contact each company with a view to validating their investment plans and the support they may need from Dubai FDI, both pre-and post-investment.

Finally, Dubai FDI expanded the tracking to also include M&As and new forms of investment as well as greenfield FDI, making Dubai FDI the only IPA in the world systematically tracking all types of FDI.

*Source:* Loewendahl, 2018



### C. Using M&E results: Improving IPA services and the investment environment

M&E reports cannot be effective if an IPA does not act on the lessons learnt or disseminate the findings. The overall objective behind M&E is to utilize the findings to improve an IPA's performance and enhance the local investment environment. By doing so, the IPA becomes more effective, while the location will 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 related knowledge products on the IPA's website. Ensure they 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, sponsors and IPA staff, to discuss lessons from the evaluation(s). These meetings could be held annually;
- Incorporate evaluation findings and lessons learnt 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 circulate widely;
- 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 the 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 to improve an IPA's investor services. During the process of acquiring information from companies for M&E purposes, an IPA will have received direct or indirect feedback from investors about the quality of its existing services as well as

ideas for additional services desired by investors. Some of the feedback might be applicable to setting higher performance standards for the length of time required to deliver services to investors. In addition, the M&E results 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 an IPA. Referring again to the quality of services offered by an 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 M&E results indicate fundamental weaknesses within the IPA, this might suggest focal areas for training of 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 to explain why the overall goals were or were not achieved and to 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. An 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 type of tangible findings that policymakers need to initiate changes.

## D. Discussion Questions

1. Does your IPA have in place a M&E system? How does it work?
2. What kind of data do you use in your M&E system? How does this compare with the suggested data to use in this chapter?
3. Does your IPA undertake mid-term reviews?
4. What KPIs does your IPA have in place?

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