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BEST PRACTICE GUIDELINES FOR INVESTMENT PROMOTION

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Introduction

1. The “best practice guidelines for investment promotion “, has been developed by OECD using the examples of smaller OECD countries, which have been successful in attracting foreign investment and using it as a major driver in developing a local SME sector. The guidelines focus primarily on the experiences of smaller, peripheral countries, which nevertheless have successfully attracted foreign investors, which might have gone to larger more prosperous countries. The guidelines also draw extensively on the work of other international agencies such as MIGA, FIAS, UNIDO and UNCTAD
2. The guidelines were developed in association with, and are intended initially for use in the transition economies of Southeast Europe. This region competes for foreign investment with the nearby EU, the world's largest single market with a combined GDP of \$8,330 billion in 1998. The guidelines draw on the experiences of countries such as Czech Republic, Estonia, Finland, Ireland and Scotland, all economies, which were successful in attracting foreign investment in recent decades.
3. The question arises as to whether this experience is relevant to the current situation between the central/western and the more prosperous coastal regions of China. The answer is that much of the experience is relevant, as there is a basic similarity of position i.e. how to get investors to act against their instinctive wish to invest in the largest market.
4. Another reason why the guidelines are relevant in this situation is that they emphasise the need to look at the investment decision from the perspective of the investor rather than the host country or region. Understanding and responding to the investor's requirements is fundamental to a successful FDI policy. This requires governments to concentrate above all on getting the fundamentals of the investment climate right (i.e. the “product”), so that investment promotion agencies are promoting an attractive environment, where the investor can do business and make an profit commensurate with the risk.

5. The process of building an attractive investment environment requires understanding and support from society, and is a long-term process requiring investment in infrastructures and reform of legal and administrative institutions and practices, which impede legitimate foreign investment. It must also involve continuous feedback from private sector investors on how they perceive the attractiveness of the location.
6. Once the basics are in place and investors have confidence in the location, they will invest. Many will and do find their own way, but modern best practice is to actively promote the location, focussing the “message “on what the investor requires and how the location can satisfy his needs. This is similar to the marketing/sales function in a private business, and requires appropriate business skills to deal with investors in terms they understand and relate to.
7. The major benefits from foreign investment arise from successful integration of the company in the local economy and the transfer of international management and technological skills to the local economy. Policy makers in successful countries look at the foreign investor as a major potential source of expertise and know-how, not just at their impact on employment and foreign reserves. Once again, “ best practice “ makes clear the need to focus on the requirements of the foreign investor, and the need to develop programmes which increases their competitiveness through local linkages. This requires a high degree of co-operation between local development agencies and the IPA, and the right skills in these agencies. The focus of many of these programmes is on building local management and technical expertise rather than on fixed asset investment. It is really about laying the seeds for long-term growth, based on an entrepreneurial culture.
8. It is worth pointing out that the same principals for an attractive foreign investment climate apply equally to local enterprise. The principals require the support of society as a whole, and an understanding of the possibilities and limitations of a private sector economy. This often requires a major change in cultural attitudes at all levels of society, and is a major long-term challenge for Chinese policy makers.
9. The institutional approach to successful attraction of foreign investment needs to recognise the fundamental fact that investors decide whether to invest or not. Policy makers need to develop institutions, which are responsive to investors’ needs. This implies clarity, confidence, simplicity, transparency and involvement of the private sector.
10. In developing the “best practices for investment promotion “, OECD looked at three main components, all inter-related but requiring different institutional approaches, reflecting the differing policy responses required. Co-ordination is absolutely necessary. The components are:
 - The role of government
 - Action by the investment promotion agencies
 - Maximising the benefits to the local economy
11. In describing the “best practices “, this paper also offers some observations on promoting the regions of central and western China to foreign investors in competition with the more prosperous coastal regions. The guidelines also include an implementation methodology, which helps countries compare their existing position with “best practice “, and outlines an implementation monitoring regime.

The role of government

The issues covered are:

- Arguing the benefits of FDI to the economy of the country
 - Securing the support of main stakeholders in society
 - Improving the climate for foreign investment
 - Removing administrative barriers to investment
 - Defining strategic policy options for FDI attraction
 - Deciding on incentives
 - Justifying the cost of attracting foreign investment
 - Defining the Government mandate for investment promotion
12. Government must first decide on the role of foreign investment in the overall development of the national economy. It must then mobilise society to pursue this goal, and make the necessary reforms in policies, institutions and personnel to create an attractive environment for private sector investment, be it foreign or domestic. Long term consistency in government policy is very important to investors. This is a long-term process. The first step for policy makers everywhere is to change their mindset from one of looking at their own needs and hopes, to one that focuses on those of the investor.
13. The principal motivating factors in private sector investment decisions are Return and Risk. In deciding on an investment location, these issues tend to reduce to:
- Market opportunity
 - Competitive cost structure of the location
 - Degree of risk for the investor.
14. In China's case, the basic decision to welcome foreign investment was taken over two decades ago, and the results have been dramatic in terms of inflows, reaching a stock of FDI of \$347 billion by the end of 1999. This is very encouraging but conceals some worrisome features. Firstly, despite the inflows, foreign investors still rate China quite lowly in terms of competitive position and risk of doing business in China (the *Institute of Management Development* survey of World Competitiveness, 2001, the *Economist Intelligence Unit* assessment of Country Risk, 2000). Paradoxically, China ranks number two in foreign investor rankings of investment intentions (*A.T.Kearney* survey of FDI Confidence, 2001), The answer lies primarily in foreign investor's perception of the growth opportunities in the enormous Chinese market.
15. Despite the major reforms of the past twenty years, the investor remains cautious but convinced. In this context, it is little surprise that over 50% of foreign investment comes from the overseas Chinese communities and is focussed mainly in the more accessible coastal provinces. This leads in turn to a vicious circle in which the coastal provinces become more prosperous and relatively more attractive to the investor.
16. The first lesson for policy makers in general is that they must not become complacent. The investor community still sees a need for major reforms to make the investment environment more attractive and to reduce administrative barriers. This is an even greater challenge for the western/central provinces as they have not participated to the same degree in the benefits of foreign investment, and have been slower to make necessary changes.
17. A second critical issue is competitiveness, which can often be an issue of accessibility. Infrastructure outside the coastal regions is a serious impediment. When addressing this issue, policy makers should try to identify those competitive infrastructure areas, where they might equal or outperform the coast.

Here, fortunately, technology is moving in the right direction for the western/central provinces. In successful countries, IPAs are focussing increasingly on knowledge industries, where telecommunications, human capital and air access are critical success factors. With the rapid development of mobile phones in China, the universal second level education system, the universal knowledge of Mandarin and the relatively extensive air connections, policy makers could look initially at the type of industries which utilise these factors (call centres, back offices, light electronics, healthcare products). Competitive labour costs could attract investors, both from abroad and from the coastal provinces.

18. A further difficulty for the investor is the sheer immensity of China. Some Chinese provinces have bigger populations than France, UK or Germany. Sichuan's population is as large as that of Japan. In even the largest OECD countries, investors are used to dealing with relatively decentralised government structures. Indeed, the more successful smaller countries pride themselves on ease of access for investors to decision-makers. In China, because of size and history, centralisation has played a strong role. Policy makers need to develop structures, which allow ease of access for the investor to decision-makers. Western/central provinces should focus more on decentralisation reforms, not only from the central government but also within their own provinces.
19. In launching the "Go West" policy, the government has recognised the need to rebalance the spread of foreign investment. The focus should be on encouragement rather than coercion. This means western/central provinces must focus efforts on continuing reform of institutions and attitudes, identification and investment in areas where competitive advantage can be achieved (such as education and communications), and they must seek out potential investors and promote their message in an effective manner. Differentiated incentives, favouring the western provinces, should be considered, but only if differentiation on the basis of competitive factors cannot be clearly established.

Action by the investment promotion agencies

The issues covered are:

- Establishing and managing the investment promotion agency
- Understanding investors and the location - creating an investment promotion strategy
- Building and managing national partnerships
- Building and strengthening the image of the location
- Targeting and generating investment
- Servicing investors
- Monitoring and evaluating investment promotion activities

20. Attracting mobile foreign investment is becoming ever more competitive, as more and more countries move towards market-oriented systems and recognise the benefits from FDI. In "best practice" countries, the responsible organisations (IPAs) have the international business and marketing skills to interface effectively with foreign investors. Many of the operations involved in the attraction of FDI are professional marketing activities. Nevertheless, government has an important input at different stages, including deciding on the appropriate structure for the agency and establishing its mandate and legal authority, budgets and senior appointments, and monitoring and evaluating the IPA's activities. In successful countries, strong emphasis is placed on involving the private sector in IPA work, at board and executive level.
21. China's case is complicated once again by size. In the international arena, it is better by far to have one IPA represent a country. This avoids confusing the investor. On the other hand, the provinces need

some assurance that investment is not all channelled along the path of least resistance towards the coastal areas. Balance is critical for long-term acceptance and support from society. Much smaller countries also face this issue, as investors will always look to the optimum location from their perspective (often the capital city). The answer has to lie in competitive advantage and risk reduction, supported if necessary, by incentives. Policy makers must insist on a co-ordinated central approach, acceptable in terms of fairness, by the western/coastal provinces,

22. The majority of investment has come from the overseas Chinese community, presumably because they are more comfortable investing in China. By the same token, these investors should be the least averse to investing in the interior, at least from a cultural perspective. Western/central provinces should focus promotion efforts primarily on the overseas Chinese community, and in particular on those companies, which have already invested on the coast.

Maximising the benefits to the local economy

The issues covered are:

- Economic policies supporting interaction between FDI and the local economy
- Developing strategies for increasing the direct benefits of FDI to the local economy - upgrading foreign affiliates
- Promoting linkages between foreign investors and the local economy
- Co-ordinating capacity building

23. In “best practice “countries, mobile foreign investment has acted as a key driver of an enterprise economy. It does this by transferring management and technical skills, by improving quality and service standards, by encouraging links with technical research institutions, by developing suppliers of goods and services, and by influencing education policy on a national level. Linking foreign investment into the local economy strengthens the security of the investment itself, while also and contributing to the development of an entrepreneurial indigenous sector.

24. Policies have to be developed and implemented to ensure these things happen and are effectively co-ordinated. It is a long and arduous process, taking many years and focussing on developing an entrepreneurial climate. Countries, which have successfully followed this route, have some policies in common:

- Same treatment for indigenous and foreign firms (national treatment)
- Active participation by the foreign investors, based on improving the competitiveness of their own investment
- Investment in higher education at secondary and tertiary levels, with emphasis on marketing, technology and language
- Encouraging entrepreneurs by eliminating unnecessary barriers and allowing them retain the fruits of their success.
- Access to development capital through equity and lending markets.
- A co-ordinated approach by development agencies

The “best practices” outline many programmes, which have been successful elsewhere. Local circumstances play such a major role that the western/central provinces need to develop their own blend from the available options.

25. In the “main issues paper “the authors highlight the success story of Guandong and the Pearl River Delta, and discuss the reasons for its comparative success. Many of these cannot of course be replicated (coastal location, nearness to Hong Kong, overseas connections etc.), but the paper does stress the “the entrepreneurial spirit of its local government cadres”, and the fact that “ in Guandong’s 50,000 processing plants a new generation of Chinese manager are educated and getting accustomed to the realities of doing business in a market environment “. Western/coastal provinces should look closely at the examples of Chinese “best practice “ in fostering an entrepreneurial climate, and they should look at developing incentive programmes to attract Chinese managers and their families to start-up new businesses to in the interior.

Conclusion

26. The “best practice for foreign promotion “seek to identify those critical areas, where successful policy intervention, can result in disadvantaged countries or regions making a success of attracting foreign investment and linking it to the local economy. It provides a framework for policy analysis and suggests how government might structure and monitor an implementation programme. The issues raised are as pertinent in China as in those countries, which provided the examples of “best practice “.

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