Chapter 2. Investment Promotion and Facilitation

Introductory note

The PFI User's Toolkit responds to a need for specific and practical implementation guidance revealed from the experience of the countries that have already undertaken a PFI assessment.

Development of the Toolkit has involved government users, co-operation with other organisations, OECD Committees with specialised expertise in the policy areas covered by the PFI and interested stakeholders.

This document offers guidance relating to the PFI chapter on Investment Promotion and Facilitation.

The PFI User's Toolkit is purposely structured in a way that is amenable to producing a web-based publication. A web-based format allows: a flexible approach to providing updates and additions; PFI users to download the guidance only relevant to the specific PFI application being implemented; and a portal offering users more detailed resources and guidance on each PFI question. The website is accessible at www.oecd.org/investment/pfitoolkit.
**Investment Promotion and Facilitation**

Within an overarching strategy for improving the investment environment, investment promotion and facilitation can help to increase both domestic and foreign investment and to enhance their contribution to national economic development. Success in promoting investment requires a careful calculation of how to employ resources most effectively and how to organise investment promotion activities within the government so that the overriding goal of economic development through improvements in the investment climate remains at the forefront of policymaking. This chapter seeks to assist countries in incorporating international best practices into their own investment promotion efforts.

Extensive advice and promotional tools already exist in this area, such as those provided by the World Bank or the United Nations, covering all aspects of investment promotion. Rather than repeating these resources at the end of each question, they are considered in more depth at the end of the chapter. Only those resources which apply to a specific question are included under individual questions.

The 9 PFI questions on Investment Promotion and Facilitation relate to:

- Business environment and investment promotion
- Investment promotion agency (IPA)
- Monitoring IPA performance
- Streamlining administrative procedures
- IPA dialogue mechanisms
- Costs and benefits of investment incentives
- Promotion of investment linkages
- Drawing on international expertise
- Information exchange networks
Business Environment and Investment Promotion

2.1 Does the government have a strategy for developing a sound, broad-based business environment and within this strategy, what role is given to investment promotion and facilitation measures?

Rationale for the question

A sound, broad-based business environment is a process as much as an outcome. Countries that have sound climates maintain them through formalised processes to evaluate business conditions and adapt continuously to competition and to changing economic conditions. Such evaluations require institutions for setting and monitoring a business environment strategy.

As part of this process, investment promotion and facilitation can help attract new investors and retain existing ones, especially in smaller, more remote markets or in those countries with a recent history of macroeconomic and political instability. Effective investment promotion highlights profitable investment opportunities, by identifying local partners and by providing a positive image of the economy. Promotion should not be seen as a substitute for more general policy reforms or try to camouflage underlying weaknesses in the investment climate.

Related PFI questions:
- Question 1.1 on laws and regulations concerning investment
- Question 2.4 on streamlining administrative procedures
- Question 3.1 on administrative barriers to trade
- Questions 10.1–10.5 on regulatory barriers

Key considerations

Having a formal process for improving the business climate requires a responsible institution with procedures to develop strategy and manage investment promotion. These tasks can be accomplished without necessarily establishing a dedicated investment agency, although many governments have taken this route. What follows are some of the key factors to be considered, which would apply equally to a single investment agency or where responsibility is assigned to relevant agencies or ministries.

A dedicated unit or decentralised approach A dedicated investment agency to lead investment promotion and strategy can be valuable, but coordination among the many ministries concerned with economic affairs and regulation remains a challenge. Different agencies have different points of view and responsibilities and hence might not all see investment proposals in the same way. If there is a central investment agency, it must have a clear strategy for
inter-governmental communication. In some ways it must act as a diplomat within government, conveying to government the concerns of business and balancing these against the different regulatory imperatives in different agencies. If there is no central investment agency, clear responsibility should be assigned to a lead ministry to develop a sound strategy for investment and create regular procedures for dealing with business and managing change.

Communication and surveying Laws and regulations may frequently have unintended consequences or, if unchanged amid changing global market conditions, become outdated or obstructive. Framing good regulatory responses to such challenges requires clear, up-to-date information, including through direct communication with existing and potential investors. Dialogue with investors is considered in Question 2.5 in the context of the IPA.

Policy formulation Reaching out regularly to business can enable the government to spot trends early and begin taking action. Once such practices point to the need for a change in regulation, there should be a clear, thorough and efficient process for formulating responses. Efforts to draft new regulations should involve government, industry and other stakeholders and should be based on sound research into best practices in other countries. Speed is an important factor. If new regulations are needed in response to deteriorating conditions in a sector, changes can be of no help if they come after businesses have closed or withdrawn from the market.

Structured approaches to proposed regulations Once a proposed policy change has been drafted, it should be circulated to interested parties and government agencies for comment as part of a regular, timely and transparent process. To work effectively, government should maintain an up-to-date database of the various industry representative bodies and major players in each market. Sufficient time is needed, both for interested parties to study proposals properly and for the government to reconsider all inputs from the period of public comment.

Policy practices to scrutinise

Investment strategy

- Does the country have an investment strategy document? Is it based on a factual study of the current investment climate and its opportunities and challenges?
- Does it offer guidance to government agencies about what sectors are to be targeted for investment promotion? Are the reasons for the selection of these sectors clear, reasonable and realistic?
- Is the strategy sufficiently flexible to allow the responsible institution to respond to new developments?
Within the agency(ies) responsible for investment promotion, are there clear goals and sectoral targets defined so that staff know their priorities? Are there sufficient staff and resources available to achieve these goals?

**Information gathering, stakeholder consultations**

- In what ways does the government gather information on the investment climate? How effective is each method? How could these methods be improved?

- Is there a clearly defined policy formulation process that involves relevant stakeholders and government agencies? Are the procedures efficient and transparent? What improvements to the policy formulation process have investors or government agencies suggested? Have they been implemented?

- Is there a clear regulation governing the processes used to gather public comment on proposed regulatory changes? Is there an efficient database and communication system to support electronic dissemination of proposals and to solicit timely feedback? Are there formal rules for how public input should be considered? Is an appeals process available when business believes proposed changes would seriously damage economic viability or impair the use of assets and investments?
Establishing an Investment Promotion Agency

2.2 Has the government established an investment promotion agency (IPA)? To what extent has the structure, mission, and legal status of the IPA been informed by, and benchmarked against, international good practices?

Rationale for the question

The World Association of Investment Promotion Agencies (WAIPA) includes 244 national and sub-national agencies from 162 different countries. The rapid growth in the number of IPAs reflects the growing importance that governments attach to investment promotion. Creating such an agency is a means to an end and will not by itself guarantee success. Some IPAs are much more effective than others. A variety of internet sites and information networks provide information on the different approaches to setting up an IPA (see Question 2.8). Comparing a national IPA against international practices can provide valuable insights and help improve the way the agency is structured and managed.

Related PFI questions

| Question 4.4 | Competition policy evaluation and intra-governmental coordination |

Key considerations

Centralising foreign investment promotion and facilitation activities, such as information dissemination and policy advocacy, within a single agency can be cost effective and can help to present a coherent impression of a country’s attractiveness to investors. The growing number of IPAs has yielded a rich body of experience on the different approaches to IPAs across countries at different levels of development. Countries that have recently established IPAs, or are contemplating doing so, can use this experience to inform the design of the IPA following international good practices.

The following elements should be considered in any evaluation of the structure, mission and status of an IPA:

Four roles for an IPA – International experience suggests four main roles for an IPA: advocacy within government to seek necessary approvals or urge the removal of obstacles to investment; image building to promote the country as an investment destination; investor servicing or facilitation to help solve problems faced by existing or potential investors; and targeting or investment generation by actively seeking out investors based on national development plans or other criteria. These roles should all be reflected in the IPA’s mission, internal structure, and funding. Image-building – including advertising, producing promotional materials and attending trade fairs – can be very
expensive, as can efforts to target particular investors owing to the high cost of research and incentives to induce the business to invest.

While there is a natural tendency for an IPA to focus on promotion, where results are most tangible, the impact of advocacy should not be downplayed. The effectiveness of the IPA in selling the country to investors depends on the quality of the investment climate. The IPA is the front-line in hearing about adverse perceptions or practical problems and thus plays a role as advocate for investors within government, whether by seeking approvals for permits or requesting fundamental changes to laws and regulations. A World Bank survey suggests that the strength of an IPA’s advocacy within government has been more critical to winning investment than the other three IPA roles. If the investment climate is sound, investors will come and the need for promotion, servicing and targeting are reduced.

The IPA’s ability effectively to resolve problems is related to its legal status, mandate and location within government. Political support is often critical in overcoming vested interests, in providing the IPA with leverage over line ministries and local governments and in ensuring investor compliance. Sustaining this political interest has proven to be a challenge, especially under changing political circumstances. In practical terms, international experience suggests that to be most effective as an advocate within government and to be able to remove obstacles to particular investments, an IPA should report directly to the president or prime minister.

**Policy practices to scrutinise**

- Where within government is the IPA located, and does it have direct access to the centre of government to facilitate its advocacy role?
- Are there provincial IPAs and, if so, how are responsibilities divided between the different levels?
- More than 70% of IPAs say they were established to act as a one-stop-shop for approvals and licensing, but investment projects often require approval from many government agencies and sub-national governments in such areas as land use, labour practices, safety, taxes and customs and the environmental impact. How can the IPA help to expedite decisions in these cases? Does the IPA’s legal mandate recognise it as the lead agency?
- Does the IPA promise completion of all investment approvals within a certain timeframe and what is its track-record in meeting this promise?
- How is the IPA budget and staff allocated across the four functional roles of advocacy, image-building, facilitation and targeting? Do these functions have the resources they need to succeed?
- How does the IPA divide its time between advocacy of investment climate reforms, image building, facilitation and direct targeting and how does this compare to international experience?
- Has the IPA engaged with agencies from other countries to learn how effectively to advocate reform and maintain good relations with government departments?
- Has the IPA studied image-building campaigns and materials from other countries to find techniques that can improve its work?
- How have other countries implemented effective one-stop-shops? Do they involve economic ministries on the IPA board, transfer permit authority to the IPA or appoint liaison officers to different ministries?
**Monitoring IPA Performance**

2.3 Is the IPA adequately funded and is its performance in terms of attracting investment regularly reviewed? What indicators have been established for monitoring the performance of the agency?

**Rationale for the question**

Below a certain level of funding, IPAs are not likely to be effective. While there is no absolute rule to determine the right funding level and different nations have different budget constraints, operating an effective IPA clearly requires substantial resources. It also requires effective monitoring to determine whether the IPA has helped to increase overall FDI inflows and how it is performing each of its four functions.

**Related PFI questions:**

Periodic reviews are a core principle of the PFI and arise in all chapters, including in Questions 1.5, 1.7, 2.6, 3.4, 5.7, 10.8.

**Key considerations**

The following are components of an effective IPA:

*Funding* – Operating an effective IPA is expensive. Hiring well-qualified staff, ideally with private sector experience, and actively engaging in image building such as through communications programmes, advertising and trade fairs all cost money. Various reports on IPA best practices also note that information technology can be an important ingredient of success to track investment patterns properly, to make effective presentations and to access international databases.

*Performance reviews* – Attracting investment is the main priority of an IPA and should be regularly monitored. Levels of FDI inflows depend on many factors: geography, access to nearby markets, natural and human resources, global and national economic growth, actions by leading investment nations, and the quality of the national investment climate. Subject to these overall constraints, IPA support for improvements in the business climate, combined with promotion and facilitation, can all help to increase the overall level of foreign investment.

Beyond an overall assessment, each of the four functions of the IPA should be evaluated separately using one or several relevant indicators. These assessments will require effective systems for gathering data on all IPA activities.
Policy practices to scrutinise

Concerning the issue of IPA funding:

- How is the IPA funded? From the government budget?
- How is the budget allocation for the IPA decided?
- Is the IPA staffed with qualified personnel?
- What is the salary range of these personnel? How does it compare with similar positions and qualifications in the private sector? Is it enough to provide motivation for the staff of the IPA?

Consideration of which sectors are attracting investment, how many jobs are created or how much technology transferred can assist in judging whether investment incentives and tax holidays are providing appropriate value for money. The factors to consider tracking include:

- Overall investment flows.
- The form of investment: portfolio investments in the stock exchange; mergers and acquisitions; expansions of existing projects; investments to establish sales and marketing facilities for foreign manufactured goods or services; and greenfield investments.
- Investment by sector: manufacturing, mining, agriculture, agricultural processing, textiles, garment assembly, retail, financial services, retail.
- Jobs created by the investment.
- Industrial linkages and additional purchases of inputs and services by each investor.
- Technology transfers.
- Net tax benefits from corporate taxes, customs duties and employment taxes paid.
Streamlining Administrative Procedures

2.4 How has the government sought to streamline administrative procedures to quicken and to reduce the cost of establishing a new investment? In its capacity as a facilitator for investors, does the IPA take full advantage of information on the problems encountered from established investors?

Rationale for the question

The importance of transparency in laws and regulations governing investment and the ways in which the administrative burden on investors might be alleviated was discussed under Question 1.1. This question considers first how the IPA might help to streamline administrative procedures involved in the establishment phase of investment, and second how effectively the IPA uses its intermediary role between the government and investors to feed investor views back into the government’s efforts to improve the investment climate.

One common approach to investment facilitation has been the establishment of a ‘one-stop shop’ which informs investors on the necessary steps to start or expand a business and speeds up the granting of permits and licences for both foreign and domestic investors. ‘One-stop shops’ also provide easy access to other information on legal and regulatory matters, on financing options, location choice, or recruitment and training. They make it easier for the government to centralise the quality provision of these services which allows potential and existing investors to save both time and money. At the same time, it is important to ensure that a ‘one-stop shop’ does not become simply ‘one more stop’.

Related PFI questions:

- Question 1.1 on laws and regulations concerning investment
- Question 2.1 on the business environment and investment promotion
- Question 3.1 on administrative barriers to trade
- Questions 10.1–10.5 on regulatory barriers

Key considerations

IPA organisation for advocacy – Providing a one-stop-shop for investors can be challenging in practice. Other agencies responsible for licensing and approvals may see the IPA as a rival or intruder on their prerogatives, particularly when it is first established. Turf battles and resistance to ceding authority to the IPA can undermine its ability to lobby for change. At the same time, other agencies are often the ones most qualified to assess a project in their area of competence, particularly its environmental impact. As discussed in Chapters 1 and 10, a balance must be established between the removal of administrative impediments and the government’s right to regulate.
Various approaches to IPA design have been attempted to ensure effective cooperation among government departments, including: leading the IPA through a board composed of key government departments; appointing IPA liaisons to key ministries; transferring legal authority to the IPA to issue the relevant permits or positioning the IPA so that it reports directly to the head of state or prime minister so as to have direct access to help in managing cooperation issues on particular investments.

Clear goals – Staff within the IPA should have a clear understanding of how to divide their time between advocacy work (and its associated research) and promotion, servicing and targeting activities. At different times, the proportions of such activity may change and the particular tactics and diplomacy needed within government will vary.

Streamlining administration – Efforts should be made to assess which administrative obstacles are most important to investors generally and within particularly strategic sectors. Once priorities are established, efforts should be made to lower the cost and increase the efficiency of these various forms of administration that affect new investments. Many of the same issues are important to existing investors and will affect their decisions about new investments or expansions. As an advocate or ombudsman acting on behalf of investors, the IPA should have structured approaches to gathering information from investors and have systems for addressing the problems investors face. The IPA should consciously adopt advocacy and influence as goals and consider which tactics and strategy are most appropriate to mitigating or removing delays in investment approvals.

Periodic reviews – No regulation will be useful forever. In time, market conditions, changing technology, inflation and foreign exchange market changes can render various regulations, taxes and duties ineffective. Thus it is a good practice to hold thorough periodic reviews of regulatory regimes to ask what could be discarded or simplified. In many instances regulations accumulate, each with a reason, but the total amount of work they create can become prohibitive. Thus consolidation of approvals, forms and other requirements can save time and money without necessarily harming the original intent of the regulations.

Policy practices to scrutinise
Factors commonly cited by investors as sources of delay or added costs include:

- the cost and time required for approvals of business licences and permits;
- approvals to purchase or lease land or change the zoning restrictions on use of particular pieces of land;
- environmental impact assessments and agreements on mitigating and monitoring environmental impacts;
- tax concessions and customs duty waivers;
- work permits for foreign senior staff and technicians;
- permits from national and sub-national governments;
- timely access to public utilities at affordable rates;
- foreign exchange regulation or restrictions on capital and dividend repatriations;
- insurance regulations for transported goods;
- various facets of labour law and pension provisions; and
- dispute resolution systems.

Some key questions related to administrative procedures include:
- What are the number and details of procedures for establishing a new investment project?
- What is the average length of time required to complete a process?
- What is the total cost for a complete process? How is it compared to other economies in the region, or other developing countries at the same level of development?
- Are ‘one-stop’ shops established by the government to facilitate setting up new enterprises or acquiring licences/permits for new investment projects? Are they set up by the IPA?
- Does the IPA provide any enquiry point for information regarding the administrative procedures required to establish a new investment?
- Does the IPA provide any assistance/support for new investors if they are faced with difficulties during this process?
- Is there any hotline in the IPA for registering complaints by established investors?
- How are the complaints handled?
- Is the IPA effectively cooperating with other relevant State agencies to address investors’ complaints?
- How are the problems based on these complaints integrated into the IPA’s proposals or advocacy for reform?
- Does the government have any plans for putting all relevant information for investors on the IPA website and for making it interactive?
Where government seeks to promote specific objectives through investment, investors and government may have to negotiate highly specific agreements. Any potential benefit in terms of industrial development goals can come at a significant cost by delaying or diverting investments. Such issues can include:

- technology transfers;
- skills development requirements;
- development of infrastructure that is directly needed by an investor or that government wants the investor to build as a public good in the vicinity of the investment;
- agreements for investors to use a certain amount of local content or engage in mineral or agricultural beneficiation;
- export-processing zone agreements;
- agreements to promote business linkages with local firms or small businesses.
IPA Dialogue Mechanisms

2.5 To what extent does the IPA promote and maintain dialogue mechanisms with investors? Does the government consult with the IPA on matters having an impact on investment?

Rationale for the question
As an interlocutor between the government and the foreign or domestic investor, the IPA is often the main source of feedback to government policymakers on the concerns of investors, as well as an effective communication channel for the government when notifying investors of policies and practices having an impact on the investment environment. This role of the IPA can be particularly useful for SMEs which, because of their small size, can have a harder time than large organisations in evaluating proposed regulatory changes or expressing concerns regarding government policy. Thus it is important that IPAs and other agencies concerned with the investment climate actively study their needs.

Related PFI questions:
Questions 4.4 and 10.2 on intra-governmental cooperation and dialogue
Questions 1.1, 3.2 and 10.4 on public consultation mechanisms and procedures

Key considerations
To be an effective voice within government arguing for improvements in the investment climate, the IPA needs to maintain regular dialogue with existing and potential investors, as well as with other government agencies.

Forms of dialogue – Mechanisms for dialogue can take many forms, including industry representation on an IPA board, an investment advisory council, monthly meetings, structured surveys and periodic discussion forums on particular issues of interest to investors. It is good practice to use a variety of forms that ensure coverage of the views of investors in different regions, types of industry and scale of operations. The IPA should ensure that businesses in remote areas and SMEs with little time or resources to devote to meetings can participate.

Scope of dialogue – Dialogue needs to include large and small investors, as well as existing and potential investors. It needs to cover general and industry-specific concerns of investors, and it should consider both existing policies and practices and proposed regulatory changes.

- Discussions with potential investors are important because they can represent new industries and opportunities and might bring up different
issues than those faced by established investors in older industries. Gathering input from potential investors can be challenging because they are not likely to be located within the economy and thus dialogue would have to occur through other forms of outreach, such as trade fairs, personal visits and surveys.

- Concerning dialogue on proposed regulatory changes, the importance of **prior notification and consultation** was discussed under Question 1.1. Investors and other stakeholders, as well as government agencies, should all have an adequate period to comment on proposals and there should be sufficient time for such comments to be incorporated into proposals. Building such notification and comment periods into statutes can help reassure all stakeholders that the government is open to their input.

**Funding** – All dialogue mechanisms require time, staff and funding, but well-planned and regular outreach to present and potential investors is indispensable in understanding the practical concerns that shape investor decisions. Because IPAs often do not have as much funding and outreach staff as they might desire, establishing priorities is important. If funds available to arrange meetings with potential investors are limited, it may make sense to prioritise such activities toward strategic sectors that build on or complement existing industries. The set of priority sectors ought to be agreed widely within the government but allow flexibility for investors in related sectors.

**Policy practices to scrutinise**

**Dialogue with business**

- How regularly and in what forums do IPA staff meet with business representatives? Has business been asked to comment on the effectiveness of these forms of dialogue or does the IPA use a survey? Do investors offer any suggestions that could improve dialogue?

- Does the IPA have private sector representatives on its board?

- Does the IPA survey existing and potential investors to gather data on investments and employment and to solicit their views on the investment climate as a way of prioritising reforms?

- Are IPA senior staff members available for meetings requested by business? Does business know that such open-door meetings are possible and welcome?

- Do dialogue mechanisms include all the major sectors of the economy, including both foreign and domestic investors?

- What special provisions are made to reach out to small businesses that often lack the time to attend regular meetings or the resources to fund a well-organised body to represent their interests?
Dialogue within government

- How often does the IPA meet with other government ministries to discuss concerns, proposed regulatory changes and business issues? Are meetings constructive and, if not, how might the format be changed to enhance cooperation?

- Do various dialogue mechanisms ensure participation of senior government officials of sufficient stature to rectify the problems discussed?

- Does the management structure of the IPA include representatives from key government departments? Some IPAs suggest that this practice can help build buy-in from those departments and assist when the IPA engages in advocacy within government.
Cost-Benefit of Investment Incentives

2.6 What mechanisms has the government established for the evaluation of the costs and benefits of investment incentives, their appropriate duration, their transparency, and their impact on the economic interests of other countries?

Rationale for the question

Offering financial and other incentives to attract foreign investors is not a substitute for pursuing policy measures that create a sound investment environment for domestic and foreign investors. Without a solid investment environment, competition among countries for FDI might simply divert public resources away from more productive uses with no effect on investment. In some circumstances, however, incentives may complement an already attractive enabling environment for investment or serve as a partial rectification for market imperfections that cannot be addressed by direct policy reforms. Each individual incentive granted may make sense at the time, but the cumulative effect of all the incentives offered might, with time, become unaffordable or counter-productive by giving investors an incentive to delay investments until they can obtain concessions.

As a result, authorities offering incentives to attract investment must periodically evaluate their relevance, appropriateness and economic benefits against their budgetary and other costs, including the long-term impact on resource allocation. In doing so, authorities also need to consider their commitments under international agreements, since investment incentives can have international repercussions, including bidding contests leading to a waste of resources. Many governments, including all OECD member countries, consider it inappropriate to encourage investment by lowering health, safety or environmental standards or relaxing core labour standards.

Related PFI questions:

- Chapter 5 on tax policies, particularly Question 5.7 on tax incentives
- All Chapters address the issue of periodic review in specific areas, e.g. Question 3.4

Key considerations

*Measuring full costs* – The IPA needs to understand the full costs of investment incentives. This should include an assessment – albeit subjective – of whether a given incentive was a critical element in the subsequent investment decision. Some incentives, such as a waiver of environmental regulations or responsibility for mine cleanups, can have enormous long-term consequences that need to be considered carefully.
**Time limits** – It is considered good practice to grant concessions, particularly tax holidays, for a finite period of time to help a new firm become profitable or direct its limited capital into productive assets that promise greater tax revenues in the future when profits grow. To offer one firm a lower level of taxation in perpetuity would run counter to the principle of equal treatment, which is an important component of a sound investment climate. Time limits also help prevent countries from having to engage in a bidding war. Particularly for developing nations, such concessions can limit the nation's revenues and indirectly force higher taxes onto existing businesses or consumers, which can harm growth.

**Broadly beneficial versus narrow concessions** – In considering what, if any, form of incentive to use, it is important to consider the broader impact. A direct tax concession to one firm may have very limited impact because it does not necessarily stimulate related industries. Some concessions can tip the balance for a given investor and also bring much broader benefits to the economy. For example, providing a specialised training programme at a university, extending or upgrading infrastructure or creating a risk insurance programme can have broad positive effects beyond the first investor to whom they are promised.

Incentives should also be weighed against the alternative uses of such funding, how scarce government resources are and the possibility of over-spending to court particular investors creating a political or social backlash where other important sectors are denied funds. Overly generous incentives, particularly for foreign investors, can undermine political support for ongoing efforts to create an attractive investment climate and can also entice investments that are not viable without the implicit subsidies that incentives represent. Incentives can also be an inducement to corruption, which can have highly adverse effects on the national image and investment climate.

**Policy practices to scrutinise**

- What incentives exist for foreign investors?
- What are the objectives and criteria for offering incentives? At what level of government are they established, and who is responsible for their implementation?
- Have proposed incentives been thoroughly examined to determine their full financial cost?
- Are there circumstances under which the expected cost of incentives would grow larger than is affordable, such as offering price supports or guaranteed prices for production when market prices are falling?
- Do incentives have an expiry period after which industry is expected to follow the general fiscal rules governing other investors?
- Do provincial or sub-national governments have the power to offer incentives beyond those specified in investment laws? If yes, are these incentives designed with due consideration of those offered by other provinces?
- Do laws or investment contracts make sufficient provision for industries to pay for environmental cleanup, particularly for mining and chemical industries?
- Has the government (national or sub-national) ever lowered health, safety or environmental standards or relaxed core labour standards to attract investment projects?
- Do incentives to foreign investors have the effect of asking domestic industry to subsidise foreign businesses through higher domestic corporate tax rates?
- Do incentives take into account the number of jobs likely to be created?
Promotion of Investment Linkages

2.7 What steps has the government taken to promote investment linkages between businesses, especially between foreign affiliates and local enterprises? What measures has the government put in place to address the specific investment obstacles faced by SMEs?

Rationale for the question

Foreign direct investment is often welcomed not just for its contribution to overall levels of investment and employment but also because it can bring additional benefits to local citizens through the diffusion of new technologies and human resource and management expertise. These spillovers arise largely through linkages between foreign investors and local firms, whether as suppliers, customers, partners or competitors. Governments often adopt proactive policies to foster greater linkages, particularly by assisting local firms wishing to supply the foreign investor. These policies are especially helpful to harness the potential of local SMEs, who account for over 95 per cent of the business population and face greater problems establishing linkages.

Related PFI questions:

All policy chapters have a bearing on the degree of linkages and technology transfer. For discussions of areas of particular importance to SMEs, see:

- Question 1.1 on laws and regulations and their impact on SMEs
- Question 2.5 on IPA dialogue mechanisms, including with SMEs

Key considerations

Efforts to improve linkages

- **Sound environment** - Linkage promotion should complement, not substitute for, active efforts to establish a sound investment environment. For instance, open trade and investment regimes combined with a strong competition policy provide a fertile environment for the transfer of technology (see also the chapters on Investment Policy, Trade Policy and Competition Policy).

- **Absorptive capacity** - Close linkages can also be promoted through government efforts to develop human resources, through investments in education, training and public health, which can all improve the capacity of a country to absorb foreign technology (see the chapter on Human Resource Development policy).

- **Linkages requirements** – Mandating linkages between foreign affiliates and local enterprises (e.g. local content, local equity or joint venture requirements) or technology transfer obligations are increasingly falling
under the purview of WTO obligations and can have a perverse effect on linkages. Not only might they discourage investment in the first place, they also might imply a lower quantity and quality of technology transferred from the parent to its foreign affiliate in the host country.

- **Targeted approaches** - Rather than focusing on investment incentives which can be expensive and sometimes yield only poor quality investments, countries may generate more jobs and more technological benefits by encouraging large anchor industrial investors to purchase from local suppliers and design support services and targeted incentives that attempt to get businesses to work together in filling the demands of large investors through local small business supply chains.

- **Linkage promotion services** can be particularly effective in matchmaking between foreign investors and domestic suppliers. The most common form is information exchange networks, as discussed in Question 2.9.

- **Targeted assistance to SMEs** - In many cases, SMEs may be unfamiliar with the quality, technical or sanitary standards required by foreign firms and thus have difficulty entering supply chain agreements with them. Training can be a valuable way to encourage linkages. Encouraging larger companies to share their material and service-sector purchasing requirements with smaller local firms can also help. In some cases, local suppliers may be individually too small to provide the needed volumes on a regular, secure basis, but efforts to create production cooperatives can assist SMEs in fulfilling the needs of larger firms. Especially in tourism and other service industries, training and facilitation can assist larger companies in sourcing supplies and labour from local communities, which can also assist in preventing labour or community disputes.

Because linkages programmes must be tailored to the specific investor and SME needs, a one-size-fits-all approach will not work. Programmes should be carefully designed with input from both investors and SMEs and should be built around regular dialogue to ensure that problems are identified and quickly corrected. Starting small and working within sectors with high potential for employment creation or technology transfer can be advantageous.

**Improving the SME Investment Climate**

- **Surveying SME views** – Small businesses often operate with very few staff and managers. With limited financial means, SMEs have greater difficulty forming business organisations to represent their interests and they have less staff time available to spend researching government proposals. Thus it is important for IPAs actively to gather information about the issues affecting SMEs through various dialogue mechanisms. A survey can be particularly important way of soliciting SME views, but it requires careful planning to ensure that it includes different business types, regions, and sizes of business.
Questionnaire design requires a solid understanding of the issues and challenges of the general business environment, and there are a variety of online sources as well as private firms that can assist. In general, questions should probe areas where known problems exist as well as permit respondents to offer unsolicited views in areas that the IPA may not have considered. Areas covered should include at the very least taxation, inflation, infrastructure, electricity, telecommunications, corruption, the speed and effectiveness of various government agencies, and access to finance.

- **Evaluating SME support programmes** – Because of their small size, SMEs can be particularly difficult to assist. Governments may create loan programmes but find that the total amount of paperwork and time needed to secure a loan is more than an SME can afford to invest. Thus it is important that surveys also seek to understand how SMEs experience government services and what dissuades them from using them.

- **Evaluating general government services** – For many SMEs, basic government functions – such as efficient and swift tax collection and VAT reimbursement processes, licensing, vehicle and land registrations – can be more important than targeted SME programmes. Businesses of all sizes report that they spend significant amounts of time navigating regulations. For small businesses, which often are run by a sole-proprietor, such tasks can directly reduce revenue by taking managers away from the conduct of business. Accordingly, speed is an important facet of government services to examine.

- **Solving indirect problems** – SMEs can be constrained by many unintended aspects of government regulation, particularly concerning access to finance. Banks are reluctant to lend when effective systems are not in place to collect on debts or identify bad debtors. For micro-businesses, basic issues like bank charges and identity requirements for opening accounts can dissuade entrepreneurs from entering the formal financial system at all. Solving such problems can require recursive dialogue among SMEs, government agencies and financiers. Policy regimes that enable governments to experiment in one region or city can provide opportunities to test what works before applying policies at a national level.

**Policy practices to scrutinise**

- Are investment incentives tied to linkage-related requirements?

- Does the IPA attempt to identify and develop competitive ‘supporting industries’ towards establishing clusters or value chains between foreign investors and domestic suppliers?

- Are there any electronic databases to facilitate business partnerships, e.g. B2B websites?
- Are there any collaborative training programmes between foreign investors and domestic supporting industries that have been organised? What are their results and level of effectiveness?
- What role could universities or technical colleges play in providing needed training?

**SME linkages**

- Investors may not be aware of potential SME suppliers. What information gathering and sharing services does the IPA offer to facilitate SME-investor linkages?
- Has the IPA prioritised its SME facilitation services?
- Having an organised representative body of SMEs can be helpful in building linkage programmes. Have such bodies been identified and brought into the IPA's other dialogue mechanisms?
- Once target or priority areas have been identified for building linkages, it is important to gather information on the products and services needed by investors and to assess the capabilities and challenges faced by SMEs wishing to participate as suppliers.
- What specific quality, quantity or delivery standards does the investor think are most important in the selection of each major product or service. Facilitating discussions between SMEs and investors on such standards can be valuable. Where gaps in SME capability are identified, what forms of training could be offered by the investor or other provider?
- Where purchasing volumes are larger, it can be more effective to work with SMEs in geographic clusters where more participants can access centralised training.
**Drawing on International Expertise**

2.8 Has the government made use of international and regional initiatives aimed at building investment promotion expertise, such as those offered by the World Bank and other intergovernmental organisations? Has the IPA joined regional and international networks?

**Rationale for the question**

Many international organisations work with IPAs to facilitate the exchange of best practices on investment promotion strategies and assist in building capacity. These advisory services can be extremely useful in improving the effectiveness of investment promotion but should not divert attention from the broader policy environment in which the IPA operates.

**Key considerations**

Benefiting fully from capacity building programmes requires assigning sufficient resources in terms of both quantity and quality within the IPA. Is the IPA or other relevant organisations making effective use of available initiatives? It may be useful to examine this question at different levels.

*Receptivity to outside information* – To what extent is the culture within the IPA, as well as in the broader government, receptive to the kinds of information available on improving the investment climate? Are there changes to the way such information is presented that might make it more accessible or understandable? Are there other strategic planning or regulatory review processes into which it needs to be fed? Some country experiences may be better matched to a given national situation and receptivity to IPA best practices may depend on choosing the right partner organisations and examples to study.

*How networks are accessed* – Participation in networks can take many forms, from the relatively passive participation in conferences to the scheduling of active research trips to meet investors and investment authorities in other countries. The IPA should ensure that participation in networks is a significant part of its activities and that there are sufficient qualified staff with adequate budgets to enable them to make effective use of information resources, whether in the form of conferences, internet-based information subscriptions or research trips abroad.

*How information is shared with government* – Senior government officials are busy and face many competing agendas. Thus careful thought should go into how the information products from IPA research should be presented. Should public communication or media outreach play a role? Should the IPA circulate concept papers or schedule informal discussion groups within government to compare national practices with best practices gleaned from external networks.
How technical experts are used – Some investment networks offer direct consultation services where experts visit a country to assist in making evaluations, studying policy options and discussing how improved practices could be phased in.

Resources
The following are some of the major networks and advice services:

- **UNCTAD** offers Advisory Services on Investment and Training for IPA staff to improve capacity, as well as a guide to international best practices and benchmarks in investment promotion.

- The **Foreign Investment Advisory Service** (FIAS) is a joint programme of the International Finance Corporation, the World Bank and the Multilateral Investment Guarantee Agency (MIGA). It provides assistance in diagnosing investment climates with recommendations for policy, regulatory and procedural reform, institutional frameworks for investment promotion and methods for monitoring effectiveness.

- The **World Association of Investment Promotion Agencies** (WAIPA) assists IPAs in advising their governments on formulating investment promotion strategies. Its website offers investment conferences and a useful set of investment links and IPA tools.

- MIGA has integrated its **technical assistance** with FIAS. Its **Investment Promotion Agency Performance Review 2006** evaluates the web sites and inquiry-handling practices of 114 developing-economy and 11 developed-economy IPAs against multi-dimensional measures of quality in these two areas. IPAworks provides website templates to assist IPAs that lack the in-house capability in setting up online resources for investment promotion efforts. MIGA also offers investment promotion toolkits and provides links to several surveys of best practices and a study showing greater investment flows for countries establishing an IPA.
Information Exchange Networks

2.9 To what extent has the government taken advantage of information exchange networks for promoting investment?

Rationale for the question

One of the roles of IPAs is to help identify potential investment opportunities by promoting partnerships between foreign and domestic enterprises. A number of initiatives exist to help governments and IPAs in their linkage promotion efforts.

Various organisations can assist with IPA issues as noted in question 2.8, but simply joining a network does not guarantee that the country derives the full potential benefit. To do so requires establishing goals and active strategies for participating in networks. Organisations should also ensure that they have adequate funding and staff to make membership meaningful. Networks provide a variety of conferences, referral services and best practice guides. Using these effectively requires that organisations dedicate staff to studying best practices and to reaching out to peers and policy advisors.

Resources

- Using linkage promotion services – A number of initiatives exist to help governments and IPAs in their linkage promotion efforts. For example, UNIDO Subcontracting and Partnership Exchanges (SPXs) act as technical information, promotion and matchmaking centres for industrial subcontracting. The SPX Network currently provides detailed, standardised, updated and certified data on approximately 20,000 manufacturing companies worldwide, thereby facilitating partnerships between contractors, suppliers and subcontractors. To date, more than 60 SPXs have been set up with UNIDO's assistance in more than 30 countries. A number of regionally-based information exchange networks also exist, such as the Asia-Africa Investment Technology Promotion Centre, established through UNIDO, to promote Asian investment in Africa. It provides a Website to share business-related information on investment opportunities between Asia and Africa.
Resources for further study

1. Investment promotion and facilitation

World Bank

World Bank agencies provide substantial training and policy advice on investment promotion. The Foreign Investment Advisory Service (www.fias.net) offers assistance in diagnosing the investment climate, with recommendations for policy, regulatory and procedural reform, institutional frameworks for investment promotion and methods for monitoring effectiveness. While FIAS has traditionally focused on investment climate reform and the Multilateral Investment Guarantee Agency (www.miga.org) on technical assistance to governments and intermediaries involved in promoting investment, MIGA’s technical assistance services were integrated into FIAS in 2007.

To support investment promotion intermediaries in achieving their objectives for attracting and retaining FDI, MIGA developed the Investment Promotion Toolkit. It serves as a handbook on investment promotion that can be used by IPAs, investment consultancies, sector ministries, international development organisations, national, state and local economic development agencies, and privatisation agencies, among others.

The Toolkit comprises nine modules devoted to:

- Understanding foreign direct investment
- Developing and investment promotion agency
- Creating an investment promotion strategy
- Building effective partnerships
- Strengthening the location’s image
- Targeting and generating investment opportunities
- Servicing investors
- Monitoring and evaluating activities and results
- Utilising information technology.

The Investment Promotion Toolkit can be found on-line at the MIGA/FIAS FDI Promotion Center (www.fdipromotion.com).

Another MIGA website (www.fdi.net) includes i.a. a directory of all IPAs worldwide, as well as links to the annual IPA Performance Review.

The World Bank Doing Business project (www.doingbusiness.org) analyses in-depth the costs of doing business and ranks country performance.

United Nations Conference on Trade and Development (www.unctad.org)


_Survey of Best Practices in Investment Promotion_, 1997

UNCTAD Advisory Services on Investment and Training provides instruction programmes for IPA staff to improve capacity (www.unctad.org/asit).

World Association of Investment Promotion Agencies (www.waipa.org)

WAIPA acts as a forum for IPAs to provide networking opportunities and facilitate the exchange of best practices in investment promotion. Membership is open to all agencies whose prime function is to promote any country or territory for investment.

2. **Incentives**

OECD

*Checklist for Foreign Direct Investment Incentive Policies*

“The Proposals on policy considerations in the use of investment incentives in the MENA region” contains a short summary of considerations on investment incentives produced for the Middle Eastern and North African governments within the framework of the MENA-OECD Investment Programme.

3. **Linkages between investors and local suppliers**

UNCTAD

*Guide to developing investment linkages programmes*

*World Investment Report 2001: Promoting Linkages*

*Business Linkages: Roster of Good Practices, 2004*

United Nations Industrial Development Organisation (UNIDO)

UNIDO operates a Cluster/Network Development Programme. See its publication, *The Italian Experience of Industrial Districts*.

UNIDO Subcontracting and Partnership Exchanges (SPXs) (www.unido.org/spx). The Asia-Africa Investment Technology Promotion Centre (AAITPC) provides an information technology platform (the TICAD Exchange Website) to share business related information on investment opportunities between Asia and Africa (www.unido-aaitpc.org).

**OECD**

*Istanbul Ministerial Declaration on Fostering the Growth of Innovative and Internationally Competitive SMEs*

**World Bank/International Finance Corporation**

The IFC offers advisory services to assist the development of the SME sector (www.ifc.org/sme).

See also the IFC webpage on linking SMEs to investment.