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Policy Framework for Investment
A Review of Good Practices

Chapter 2

Investment Promotion and Facilitation*

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2.1. Introduction

Although domestic firms are by far the largest investors in developing and transition economies, foreign investors are often particularly sought after for their technology, skills and expertise and for their access to international markets. Most governments, including sometimes at the sub-national level, now actively promote foreign investment through agencies mandated to this effect and offer a range of inducements to link multinational enterprises (MNEs) more closely to the local economy. The traditional aims of foreign direct investment (FDI) policy in terms of employment, exports and, to a lesser extent, import substitution still exist, but the overall emphasis in now much more on the contribution of foreign MNEs to the overall development and competitiveness of the local business sector.

This background document focuses on what steps a government might take to promote and facilitate investment in the host country, including that of encouraging any potential spillovers from foreign investment to local enterprise development, based upon experience in both OECD and non-OECD economies. It serves as background documentation for the investment promotion and facilitation chapter of the *Policy Framework for Investment*.

2.2. Strategic investment promotion: the overall framework

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?

Measures to promote and facilitate investment can be successful if they take place within the broader context of an overarching strategy for improving the investment environment, which involves mainstreaming investment across a broad range of policy areas that affect the investment climate, such as those covered in the PFI. Developing a broad strategy for investment requires strong political support and leadership, both from the highest levels of government as well as from front-line agencies and ministries responsible for implementing policy. One recent study suggests that, without an appropriate business climate for investment, promotional efforts might actually make foreign investment less likely. Morriset (2003) reviews the performance of investment promotion agencies in 58 developing and transition countries in terms of the level of FDI inflows. He finds that investment promotion is more effective in a country with a good investment climate and can even be counterproductive if the country offers only a poor investment climate. “It seems more difficult to convince an investor to come back if he was disillusioned during his first visit to a country. The disappointed investor is also likely to be vocal about his disenchantment and, so, discourage other potential investors.”[1] He argues that countries with a poor investment climate would be better off spending limited resources on the climate itself rather than on promotion.

However, once a country is establishing a generally sound investment climate, governments can take additional steps to promote and facilitate investment. Foreign investors by themselves might be slow to perceive profitable opportunities in the host economy, especially in smaller, more remote markets or those with a history of political unrest. They might also prefer to deal with existing suppliers elsewhere rather than take the time and effort to establish contacts with local firms. Active promotional policies by the host government can encourage both investment and linkages with local firms. A common institutional approach to such promotion is to create an Investment Promotion Agency (IPA) or other institutional facility. Not only can the IPA help simplify administrative procedures, improve regulatory transparency and focus investment promotion, it can also serve as a conduit for private sector input into the reform process itself. In many cases, the IPA is also used as a vehicle for expanding linkages between foreign investors and domestic suppliers.

2.3. The investment promotion agency

As part of the South East Europe Compact for Reform, Investment, Integrity and Growth, the OECD has formulated Strategic Guidelines on Investment Promotion addressed to IPAs based on practices developed in some of the most successful host countries for foreign investment.[2] These include:

- the establishment of an IPA or other institutional facility,[3] as well as its objectives and the relevant legislative and governance structures;
- to inculcate within the IPA a professional management and service culture, result-oriented ethos and innovative marketing approach in order to compete successfully in attracting new investment and to ensure satisfactory continuity of the organisation culture; and
- to define strategic policy options and set out the corporate strategy and marketing plan of the IPA to build competitive strength and achieve selected policy options.

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?

Centralising many of the functions of government relating to foreign investment promotion and facilitation within a single agency is a popular method of organising and implementing a government's strategic investment promotion policies. The World Association of Investment Promotion Agencies (WAIPA) had 188 members as of February 2006, compared with the existence of only a handful two decades earlier.[4] The life cycle of an IPA can be summarised as follows: 1) image building; 2) investment generation; and 3) linkage promotion. At the same time, the IPA serves two additional functions at each stage of the life cycle: *a)* information dissemination and investment facilitation; and *b)* policy advocacy.

At any given time, an IPA will perform all of these functions to varying degrees, but over time the IPA tends to reorient its resources towards the latter phases as the level of foreign investment increases in the economy. The principal aim of an IPA, at least in the early stages, is to draw attention to profitable investment opportunities in the host economy. Low levels of foreign investment are not necessarily evidence of a lack of such opportunities.[5]

Owing to limited IPA resources and faced with the almost limitless supply of potential investors promotional efforts have in some cases focussed on those firms most likely to invest. This requires an understanding both of how geography influences investment patterns and of "what investors are seeking, their view of the country as an investment location, the needs of their particular sector and company, the country's competitive advantages for attraction of FDI and how it compares with other countries".[6] An UNCTAD survey of IPAs found that they are focussing more and more on such targeting, to a greater extent than on either additional incentives or further liberalisation.[7]

Targeting of industries or even individual firms usually involves promoting particular locations to investors in specific activities. Such an approach takes time and relatively sophisticated institutional capacities. Targeting of the most likely investors can sometimes give way to an implicit industrial policy whereby targets are chosen based on a desire to develop certain industries deemed to be strategic. A discussion of industrial policy would go beyond the scope of this chapter. However, there is a need for caution when targeting potential investors because identifying specific industries that might emerge as winners has always proven a difficult task. Furthermore, to the extent that targeting provides preferences for some firms over others, this could also have negative implications for competition. Nonetheless, proactive strategies based on sound analysis of the comparative advantages and market opportunities of a particular market or country, perhaps even taking into consideration the specific needs of different types of investors (*e.g.* market seeking, efficiency seeking and natural resource seeking) remains an important policy option, especially for countries that have particular advantages that the broader international investment community might not be aware of.

2.3.1. Characteristics of a successful IPA

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?

Experience suggests that unless there is a full commitment to investment promotion agencies by the government, they are less likely to succeed in attracting new investors. They need to be adequately funded in order to attract and retain qualified and motivated staff, ideally with private sector experience. Experience also suggests that agencies with links to the centre of government and with private sector representation on the board have higher visibility and credibility and hence a better record in attracting foreign investment. They are also more dynamic and adaptable to changing economic circumstances, a critical issue for countries undergoing major economic transformation.

Morriset (2003) provides a number of insights into the characteristics of a successful IPA. Agencies with links to the centre of government and with private sector representation on the board have higher visibility and credibility and hence a better record in attracting foreign investment. They are also more dynamic and adaptable to changing economic challenges and opportunities, a critical issue for countries undergoing major economic transformation. Size also matters: Morriset finds that "small agencies are not really effective in attracting FDI".[8] A minimum budget is essential if promotion is to yield results. Overall, the author finds that IPAs can help countries to attract FDI: every one per cent increase in the IPA budget yields an increase in FDI of 0.25 per cent.

2.3.2. Investment facilitation and the one-stop shop

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?

Long delays and costly procedures to establish a new business entity is one of the obstacles to new investment and entrepreneurial activity. Many governments have introduced reforms to quicken and simplify the process of starting a new business. One common approach to this challenge has been the establishment of a "one-stop shop". These allow investors to access information on the necessary steps to start or expand a business and provide services to speed up the granting of necessary permits and licenses. "One-stop shops" also provide easy access to other information that helps to facilitate investment, both domestic and foreign, for instance, on legal and regulatory matters, on financing options, location choice, or recruitment and training. "One-stop shops" make it easier for the government to centralise the quality provision of these services. This can deliver substantial savings in time and cost to potential and existing investors, thereby facilitating new investment. (on the positive effects of easing business registration requirements, see Box 2.1).

Investment facilitation is not just about helping firms navigate administrative barriers. Once the country starts to attract the interest of investors, the "process of country visits, negotiations, advice, legal and regulatory matters, visits with existing investors, financing, location choice, property, recruitment, training, and post-investment facilitation must all be provided in a professional way to the investor".[9]

Because potential investors often seek out existing foreign investors, particularly from their own country or sector, to ascertain their experience in the host economy, IPAs should also facilitate ongoing operations and expansion by existing investors. In an extensive survey of investment promotion in sub-Saharan Africa, UNIDO found that investors indicated that they were far more likely to be attracted to a location based on the recommendation of an existing investor. For this reason, satisfying existing investors should be the "centrepiece of any promotion strategy".[10]

As well as providing information, one-stop shops are sometimes conceived as a way to centralise the approval process for foreign investment. This was particularly the case in the past when investments were screened. But allowing one agency to grant all licences, permits, approvals and clearances has often proved unworkable. In worst cases, the one-stop shop becomes one more stop, adding to the red tape facing the investor. Governments

Box 2.1. **Easing business registration requirements**

Opaque and complex business registration requirements discourage new firms from entering the formal economy. Viet Nam and Uganda illustrate successful strategies for reducing these costs through simpler, more transparent regulation.

Viet Nam: before a new Enterprise Law was enacted in January 2000, business registration and licensing requirements were extremely burdensome in Viet Nam. Entrepreneurs were required to submit detailed business plans, curricula vitae, character references, medical certificates, and other documents along with their applications for registration. On average, registering a business took about three months, and required visits to 10 different agencies and submissions of about 20 different documents with official seals. Additional licenses were often required before firms could start operating. Some of these licenses did not appear to serve vital public interests (such as those to operate photocopying machines). It took 6 to 12 months to fulfil the legal requirements to establish a business at a cost of $700 to $1 400. The new law reduced the costs of establishing a new business. The time to establish a new business came down to about two months – with business registration taking only 15 days – and total start-up costs were reduced to about $350. Viet Namese entrepreneurs responded. Fewer than 6 000 new businesses had registered in 1999, but the number shot up to more than 14 000 in 2000 and to more than 21 000 in both 2001 and 2002.

Uganda: a recent pilot program in Entebbe reduced the time and monetary costs to register a business. By streamlining licensing processes and reducing the number of previously required approvals and assessments, the time to register a business was reduced from two days to about 30 minutes. This reduced the cost of registering a business by 75 per cent. Although business registration is only one of several steps to start a new business in Uganda (businesses have to register for tax purposes and many need additional licenses), the cost can be significant because registration needs to be repeated annually for most businesses. The pilot program increased business registrations, with an estimated four times as many businesses registering in Entebbe the year after the pilot. Despite the lower fees, the higher number of registrations meant that revenue collections increased by 40 per cent. With administrative savings of 25 per cent in staff time and 10 per cent in financial resources, the program also benefited the municipal authority.

Source: From Box 5.4, World Bank, *World Development Report* 2005, p. 101, based upon Mallon, Raymond. 2004. "Managing Investment Climate Reforms: Viet Nam Case Study". Background paper for the WDR 2005 and Sander, Cerstin. 2004. "Less is More: Better Compliance and Increased Revenues by Streamlining Business Registration in Uganda." Case Study Commissioned by the UK Department for International Development for the 2005 World Development Report.

are rarely willing to vest decision-making authority within one single organisation, especially concerning an issue as politically sensitive as foreign direct investment. Line ministries also resist ceding their regulatory authority to another agency.

Because of these difficulties, many one-stop shops have failed to live up to expectations. UNIDO argues that "no research or evidence has been found that [the one-stop shop] is indeed the magic solution for sub-Saharan Africa".[11] It proposes instead that the IPA should liaise closely and effectively with relevant government administrative entities rather than trying to internalise all approval and implementation functions. Nevertheless, an IPA that is conceived as a one-stop shop from the investor's perspective (in the sense that it acts as a liaison between the investor and the various branches of government involved) can play a useful role as a facilitator or mediator in cases of difficulty.

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2.3.3. Image building

Image building is a foundation block in the process of attracting FDI. Its role is primarily that of focusing investor interest on the location and overcoming negative perceptions rather than directly persuading a multinational company to invest. Indeed, it has been argued that "the perceived investment climate is as important as the actual one and so addressing negative perceptions is an important part of encouraging investment."[12] As with any brand, the Agency needs to create an image of the host country in the eyes of

Box 2.2. **Uganda: from pariah to paragon**

The example of Uganda demonstrates how persistence and political will can pay off even in what are seen as the most unfavourable circumstances and where much still remains to be done. The Ugandan experience highlights the following essential features:

- Investment promotion should be embedded in an overall framework of liberalisation.
- Political support is essential.
- Consistency and persistence are more important than the actual state of openness.
- Investors will come even if certain elements of the enabling environment are still "under construction".

History has not always been kind to Uganda. Once dubbed the pearl of Africa, Uganda fell prey to dictatorship and armed conflict in the 1970s and 1980s. The economy was crippled, first by nationalisations in the 1960s and then by the expulsion of the Asian community in the early 1970s. Although only a small share of the total population, they were the mainstay of commerce and industry. In terms of investment attraction, Uganda is also hindered by its own geography: a landlocked country with few easily exploitable natural resources and located within an unstable region.

In spite of these drawbacks, Uganda has been one of the fastest growing economies in sub-Saharan Africa and also one of the most successful at attracting inward investment relative to its economic size. Investment promotion has been a crucial element in the country's development strategy but would probably by itself have yielded little extra investment had it not been part of a broad and consistent pattern of liberalisation which has assured investors about the direction the economy is heading. The Uganda Investment Authority has also enjoyed strong political support at the highest levels.

Uganda has managed to attract investment even though the 1991 Investment Code is "a restrictive and control-oriented regime for FDI, and if implemented to the letter or in an unsympathetic spirit, it could seriously deter FDI".[*] Under the Code, the government has the authority to restrict any investment it deems contrary to the interests of Uganda. That Uganda has managed to entice investors in spite of this potential for restrictiveness speaks to the importance of a track record of liberal implementation of existing laws. Nothing assures investors as much as consistency.

Not everything is perfect in the eyes of investors. In addition to weak physical infrastructure, firms complain of delays and corruption in customs and tax administration and a poor record in the courts of adjudicating fairly and promptly on commercial disputes. The lower echelons of government have resisted attempts to reduce their regulatory role as a result of liberalisation. But with a government committed to reform, investors are more willing to abide by these shortcomings.

* UNCTAD (2000), p. 22.

Source: UNCTAD 2000.

investors. This is particularly important for countries with little track record in attracting foreign investment, those undergoing rapid political or economic reform or emerging from a period of civil unrest, and those countries which are too small to attract the attention of home country media and hence are not even on the map for multinational investors. In this context, regional promotion can play an important complimentary role to country-level promotion since many prospective investors think in regional terms (*e.g.* "should we invest in South East Europe or in the Baltic?"). The recognition of this fact has motivated the growing interest in regional promotion networks.

While neighbouring countries often see themselves as competitors for FDI, it is more likely that successful promotion in one country will enhance the prospects for investment in neighbouring countries, especially in those regions which are less well known by investors. For this reason, there are often economies of scale to be had by undertaking certain promotion missions jointly at the image-building stage.

The evidence suggests that such image building can be expensive but that, with a good deal of persistence, host countries can succeed in overcoming negative perceptions (Box 2.2 on Uganda). At the same time, image building should not detract from broader efforts to improve the investment climate or divert scarce resources away from other functions of the IPA. Furthermore, image building does not only involve "grand plans" but can also involve addressing more basic "quality of life" issues, such as the quality of services offered by immigration authorities and agencies responsible for granting visas. The UNIDO survey mentioned earlier found that "IPAs in the region play only minor role in the process of awareness creation".[13] Morriset (2003), in a survey of 58 IPAs from various regions, found that image building does yield results in terms of attracting investment, but less than policy advocacy.

2.3.4. Policy advocacy

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?

Most countries now accept that FDI can play a key role in economic development and consequently actively seek foreign investors. Support for such a policy among local consumers and workers or within the lower echelons of government is not always guaranteed. Foreign investment is often associated with more general market-opening policies and the private provision of infrastructure, both of which can prove unpopular within host countries. Allied to more general discontent, government ministries, regional governments and lower level civil servants have often resisted relinquishing their regulatory powers over foreign investors.

An IPA or a one-stop shop is not a substitute for regulatory reform. It can nevertheless serve as a useful exercise by indicating to the host government the extent to which business licensing requirements are cumbersome or redundant. It can also send valuable signals to foreign and domestic investors that the government is serious about reform and promoting investment.[14] A more direct approach to simplifying procedures would be to improve the efficiency of each individual ministry responsible for particular aspects of investment approval. In Tanzania, for example, a "no objection" provision in the Investment Code means that unless a ministry objects within 14 days, the Tanzania Investment Centre is entitled to approve the application.[15]

Investment promotion agencies can play an important role facilitating effective communication between investors and the government. As the interlocutor between the government and the foreign investor, the IPA is often the main source of feedback to government policymakers on the concerns of investors. Conversely, through its regular contact with government and the relevant government agencies, the IPA can be an effective communication channel for investors on government activities having an impact on the investment environment.

Morriset (2003) finds that IPAs which spent more time on policy advocacy were more successful in attracting investors, possibly because of the role of such advocacy in leading to improvements in the investment climate.

2.3.5. Investment promotion through specific incentives

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?

The use of financial and other incentives to attract foreign investors (also see the chapter on Tax Policy) is not a substitute for pursuing policy measures that create a sound investment environment, for domestic and foreign investors alike. In the absence of a solid investment environment, competition among countries for FDI may lead to no overall increase in investment and divert public resources away from more productive uses. 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. Nonetheless, authorities engaging in incentive-based strategies to attract investment must periodically evaluate their relevance, appropriateness and economic benefits against their budgetary and other costs, including long-term impacts on resource allocation. In doing so, authorities also need to consider their commitments under international agreements, since investment incentives can have effects beyond the countries that offer them, including bidding contests leading to a waste of resources. Many governments, including all OECD member countries, consider that it is inappropriate to encourage investment by lowering health, safety or environmental standards or relaxing core labour standards.

It is for these reasons that the OECD Investment Committee developed a Checklist for Assessing FDI Incentive Policies (see Box 2.3). The Checklist serves as a tool to assess the costs and benefits of using incentives to attract FDI; to provide operational criteria for avoiding wasteful effects and to identify the potential pitfalls and risks of excessive reliance on incentive-based strategies. The Checklist and its application to considerations of investment incentives can have a positive effect in minimising potential harmful effects of incentives both for those that employ them and for other governments seeking to attract foreign investment.

Box 2.3. **The OECD Checklist for FDI Incentive Policies**

The desirability and appropriateness of offering FDI incentives:

- Are FDI incentives an appropriate tool in the situation under consideration?
- Are the linkages between the enabling environment and incentives sufficiently well understood?

Frameworks for policy design and implementation:

- What are the clear objectives and criteria for offering FDI incentives?
- At what level of government are these objectives and criteria established, and who is responsible for their implementation?
- In countries with multiple jurisdictions, how does one prevent local incentives from cancelling each other out?

The appropriateness of strategies and tools:

- Are the linkages between FDI attraction and other policy objectives sufficiently clear?
- Are effects on local business of offering preferential treatment to foreign-owned enterprises sufficiently well understood?
- Are FDI incentives offered that do not reflect the degree of selectiveness of the policy goals they are intended to support?
- Is sufficient attention given to maximising effectiveness and minimising overall long-term costs?

The design and implementation of programmes:

- Are programmes being put in place in the absence of a realistic assessment of the resources needed to manage and monitor them?
- Is the time profile of incentives right? Is it suited to the investment in question, but not open to abuse?
- Does the imposition of spending limits on the implementing bodies provide adequate safeguards against wastefulness?
- What procedures are in place to deal with large projects that exceed the normal competences of the implementing bodies?
- What should be the maximum duration of an incentives programme?

Transparency and evaluation:

- Have sound and comprehensive principles of cost-benefit analysis been established?
- Is cost-benefit analysis performed with sufficient regularity?
- Is additional analysis undertaken to demonstrate the non-quantifiable benefits from investment projects?
- Is the process of offering FDI incentives open to scrutiny by policymakers, appropriate parliamentary bodies and civil society?

Extra-jurisdictional consequences:

- Have authorities ensured that their incentive measures are consistent with international commitments that their country may have undertaken?
- Have authorities sufficiently assessed the responses that their incentive policies are likely to trigger in other jurisdictions?

2.3.6. Facilitating linkages

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?

Countries benefit from FDI in part because the intangible assets (proprietary technology, management and marketing skills) transferred between the parent and its foreign affiliates spill over into the local economy. These spillovers arise largely through linkages between foreign investors and local firms, whether as suppliers, customers, partners or competitors.

At the broadest level, the benefits from inward investment depend on the enabling environment. Open trade and investment regimes combined with an active competition policy generally provide a fertile environment for the transfer of technology. The underlying assumption is that the more a firm is forced to compete, the more technology it will have to transfer to the affiliate in order for it to be competitive in that market. At the same time, the host government can undertake measures to improve the absorptive capacity of the local economy in order to enhance technology transfers, such as through education and training and investments in human capital. "Countries that succeed in continuously fulfilling the evolving skills needs of industry will have a very strong competitive advantage in attracting new investment and moving up the skill and value chain in the type of industry attracted."[16]

In the past, governments have tried to mandate linkages through local content, local equity or joint venture requirements and sometimes even direct technology transfer obligations. However, increasingly policy makers are seeking to promote more "natural" linkages as, for example, through electronic databases aimed at facilitating business partnerships. One reason for this change in approach pertains to the generally poor results associated with enforced linkage policies. For example, when foreign investors are given a protected market as a *quid pro quo* for performance requirements, they have little incentive to transfer the latest technology to their affiliates, and local firms are often happy to partake in the economic rents created by protection rather than enhancing their own competitiveness through linkages with foreign firms. The same result of weak technology transfers can arise when the investor is forced into a joint venture with a local firm. When Kodak invested in China, for example, it was allowed only one wholly-owned subsidiary, while the rest of its affiliates had to form joint ventures. The result was that Kodak invested six times more in its wholly-owned affiliate than in the joint ventures, and the former ended up producing its most advanced film and camera technologies.[17]

Performance requirements have largely been supplanted by a more flexible system in which incentives are offered to the investor in return for the fulfilment of certain obligations relating to linkages. Investors are in theory free to refuse such obligations, although when they include exemptions from import duties, the export oriented investor might find its options limited. Nevertheless, some host country governments have successfully promoted linkages by offering positive inducements for firms to comply.

The countries most frequently cited in this regard are Singapore, Ireland and Malaysia. Under Singapore's Local Industry Upgrading Programme (LIUP), the Economic Development Board provides financial and organisational support for an engineer or manager from a foreign affiliate to assist local suppliers over two to three years. As of 1999, the LIUP resulted in linkages between 670 local business and 30 foreign affiliates and 11 large local enterprises, government-linked companies and government agencies. The general consensus concerning the LIUP is that "Singapore's approach, combining a targeted FDI promotion strategy with a linkage programme, has had positive effects on economic deepening".[18]

The approach taken by countries like Singapore and Ireland reflect the growing recognition of the vital role that small- and medium-sized enterprises play in any economy. These usually account for over 95 per cent of the business population, driving innovation, and underpinning sustainable economic growth and job creation. Conversely, they also tend to suffer most when the policy framework for investment is weak, they have more difficulties gaining access to credit, and they often lack the capacities required to develop relevant linkages with customers and suppliers. For these reasons, policy makers increasingly formulate policies that take into account the needs of SMEs and that promote SME development. Indeed, an OECD Ministerial Conference held in Istanbul, Turkey, in June 2004, focussed specifically on policy priorities for supporting SMEs. These are summarised in the Annex.

If Ireland and Singapore are generally considered as success stories, there are nevertheless certain key facts which need to be kept in mind by any government wishing to follow in their footsteps. Firstly, linkage programmes are expensive: the two countries spend over $40 million each annually, for a population of under four million in each case.[19] This compares with an annual average budget of only $450 000 among the 58 IPAs surveyed by Morriset (2003). Secondly, the Economic Development Board of Singapore and the Irish Development Agency have strong powers within the government to shape and implement policy in this area. Thirdly, both countries have a large pool of skilled workers and of small firms with the capacity to become suppliers to foreign affiliates. The success of these programmes depends in large part on the active and willing collaboration of existing investors. By providing financing and organisational support, the relevant government bodies reduce the perceived risks to foreign investors from engaging in capacity building among suppliers.

2.4. International co-operation for investment promotion and facilitation

In the long run, support for improvements in host country business climates and technical assistance to develop local human capital and supply capacity in local firms will have the greatest impact on investment flows to developing countries. Development assistance by bilateral and multilateral donors provided over $20 billion each year towards business climate improvements in developing countries between 1998 and 2002. Much of this went towards infrastructure (54 per cent), followed by policy-based support (33 per cent) and technical assistance (13 per cent).[20] But such improvements often take time to bear fruit. In the interim, there are many measures which can expand both global investment and linkages with local firms.[21] Such measures have proliferated in recent years.

2.4.1. IPA capacity building

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?

Various international organisations participate in capacity building with regional IPAs (see Box 2.4 for the example of MIGA). In addition, the World Association of Investment Promotion Agencies (WAIPA) provides networking opportunities among IPAs and facilitates the exchange of best practice. WAIPA also assists IPAs in advising their respective governments on the formulation of appropriate investment promotion strategies.

The Foreign Investment Advisory Service within the World Bank Group provides investment climate diagnostic studies at the request of host governments. These studies look generally at the legal and regulatory environment in the country concerned, as well as competition policy, market structure and privatisation. They also examine investment promotion policies and institutions and direct and indirect taxation regimes, including investment incentives. In addition, FIAS investment promotion assistance consists of recommendations for a combination of policy, regulatory and procedural reform; institutional frameworks for investment promotion; and methods for monitoring effectiveness. FIAS projects include advice in the following areas:

- developing strategic approaches to attract FDI;
- designing the legal foundation for investment promotion;
- designing the organisational framework for national and sub-national IPAs;
- conducting surveys to help client governments better understand how prospective and lost investors perceive the country.[22]

Box 2.4. **MIGA's Investment Promotion Toolkit**

Recognising the many challenges faced by IPAs in their outreach efforts to investors, the World Bank Group's Multilateral Investment Guarantee Agency (MIGA) developed the Investment Promotion Toolkit. The toolkit is designed to support investment promotion intermediaries in achieving their objectives for attracting and retaining FDI. 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 consists of nine modules: understanding trends and drivers behind FDI; developing an IPA; creating an investment promotion strategy based on the locations strengths and weaknesses; building effective partnerships with other organisations; strengthening the location's image; targeting and generating investment opportunities, including maintaining a lead tracking database; servicing investors, including visits, follow-up and aftercare; monitoring and evaluating activities and results; and utilising information technology.

Source: OECD (2002a, p. 41), based on MIGA.

UNCTAD publishes both Investment Policy Reviews and Investment Guides (jointly with the International Chamber of Commerce) in order to improve the policy environment for investment in the host country and to call attention to investment opportunities in that market. UNCTAD's Advisory Services on Investment and Training (ASIT) has 30 years of experience in providing training aimed at increasing the capacity of developing and transition economies to attract and benefit from FDI. ASIT services cover investment policies, enabling legal and regulatory frameworks for investment, and investment promotion strategies.

UNIDO has an active technical assistance programme with sub-Saharan IPAs. The UNIDO-Africa Investment Promotion Agency Network comprises sub-Saharan IPAs, UNIDO offices and an advisory panel from the private sector. The Network is a working group which explores practical, low cost schemes to improve the effectiveness of its member agencies in mobilising domestic and foreign investment. It is also a permanent platform for training, capacity building and continuous linkage to UNIDO's worldwide network of Investment and Technology Promotion Offices.

Other examples of regional initiatives working with IPAs are the South East Europe Compact for Reform, Investment, Integrity and Growth ("The Investment Compact") and the MENA-OECD Investment Programme. The MENA-OECD Investment Programme is working with MENA IPAs as key actors to improve the investment framework and promote a more positive image of the region. Apart from their concrete project oriented work, key challenges for IPAs in the MENA region remain the provision of effective policy advocacy in areas such as changes in regulatory frameworks, enactment of investment-friendly policies, building competitive sectoral strategies, effective investor targeting, the provision of post-investment services, and promoting linkages between international and domestic investors.

In addition to the various programmes mentioned above, many other initiatives are bilateral. For example, the Japan International Cooperation Agency (JICA) regularly sends experts to ASEAN and Eastern European countries' IPAs to provide technical assistance. As part of the MEDA co-operation programme between the European Union and ten partner states in the south and east Mediterranean, the European Commission supports the ANIMA project, which aims at developing a Euro-Mediterranean network of IPAs.[23] The ultimate goal of the project is to increase foreign direct investment in the Mediterranean region from either the EU or other Mediterranean countries through a reinforcement of the capabilities of the MEDA IPAs.

Faced with this plethora of training programmes, IPAs are not lacking advice on how to adopt best practices elsewhere. But resources are often limited and choices have to be made, and it is not necessarily clear that all countries can pursue the same strategies. More empirical work is needed to help IPAs choose among the tools available to promote investment. In addition, Morriset (2003) demonstrates that IPA effectiveness in investment generation is partly a function of external factors: the local business climate, the degree of political support and the resources available. IPA promotion can doubtless be made more efficient and focused, but such training and advice should not divert attention from the broader policy environment in which the IPA operates.

2.4.2. Promoting linkages

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

International agreements promoting technology transfer

International agreements can be used to foster greater linkages. In the area of intellectual property, the TRIPs Agreement contains specific provisions for technology transfer. Article 66(2) requires developed country members to "provide incentives to enterprises and institutions in their territories for the purpose of promoting and encouraging technology transfer to least developed country members in order to enable them to create a sound and viable technological base".

The OECD Guidelines for Multinational Enterprises represent a political commitment on the part of adhering governments to promote observance of their recommendations for MNEs based in any signatory country and operating anywhere in the world. They provide government-backed voluntary principles of good corporate conduct and include procedures for implementation and follow-up. Under the Guidelines, enterprises should: 1) encourage local capacity building through close co-operation with the local community, including business interests, as well as developing the enterprise's activities in domestic and foreign markets, consistent with the need for sound commercial practice; 2) encourage human capital formation, in particular by creating employment opportunities and facilitating training opportunities for employees; and 3) adopt, where practicable in the course of their business activities, practices that permit the transfer and rapid diffusion of technologies and know-how, with due regard to the protection of intellectual property rights.

Matching suppliers with foreign investors

UNIDO Subcontracting and Partnership Exchanges (SPXs) act as technical information, promotion and matchmaking centres for industrial subcontracting, OEM and partnerships between main contractors, suppliers and subcontractors. The SPX Network provides detailed, standardised, updated and certified data on approximately 20 000 manufacturing companies worldwide. To date, more than 60 SPXs have been set up with UNIDO's assistance in more than 30 countries. SPXs also organise "Supply Development and Upgrading Programmes" for clusters of small-scale suppliers and subcontractors to assist them in meeting the higher resolution quality requirements of major international contractors and buyers.[24] The OECD also provides South Eastern European countries with these sorts of matching opportunities to promote investor-local enterprise linkages.

Forum based activities such as the Tokyo International Conference on African Development (TICAD) process have also been contributing in this effort. The Asia-Africa Investment Technology Promotion Center (AAITPC) was established by TICAD in 2003. The activities of the Center are funded by the Japanese Government and implemented through UNIDO in order to promote Asian investment in Africa by providing opportunities between businesses in the two regions. Recently, the TICAD process established a network to facilitate exchanges of business-related information via information technologies (the

TICAD Exchange Web site) and interaction in both public and private sectors for the promotion of trade and investment between Asia and Africa.

2.5. Conclusion

Investment promotion and facilitation measures can make a difference. Multinational enterprises are sometimes slow to spot profitable investment opportunities and often hesitate before using local suppliers. But successful promotion is expensive and resources need to be used wisely. Some IPA roles are more useful than others, depending on the stage of development of the host economy and the existing stock of FDI in that country.

Investment promotion should complement, not compensate, for a poor investment climate. Without a suitable enabling environment, promotion might even be counterproductive. Similarly, under funded IPAs might also make matters worse since an ineffectual IPA reflects badly on the overall investment climate in the eyes of investors. Successful IPAs are characterised by private sector involvement in its activities and strong political support. One-stop shops are not effective, if they do not help to simplify regulations and mandate a rapid response to investor requests from each relevant ministry.

The positive impact of an IPA may be indirect: through its role in helping to shape policy. The IPA is often the government interlocutor with investors and through its function as a one-stop shop is intimately aware of the complexity of local regulations. There is evidence that the more resources devoted to policy advocacy, the greater the inflows of investment. Agencies in poorer countries should consider also concentrating their efforts on addressing problems encountered by existing investors than on spending money on expensive advertising campaigns and missions to potential home countries. An existing investor's recommendation is often the best promotional tool.

Targeting of investors or industries is often a strategy born of necessity. Such targeting should be based on an assessment of those MNEs most likely to invest and with an industrial profile that best fits with the existing industrial structure in the host economy. It should also be based upon sound analysis of the advantages and opportunities in the country concerned.

Linkages depend first and foremost on the quality of local human capital and on the domestic policy environment. Investors can nevertheless often benefit from the matchmaking services of the local IPA, but such services demand strong institutional capabilities. Successful linkage promotion programmes rely heavily on the foreign investors for training and capacity building. They can only function in an environment of trust.

Notes

1. Morriset (2003), p. 19.
2. Based on OECD (2002a), p. 12.
3. Governments do not always establish a separate agency but sometimes set up a division or a directorate within the existing bureaucracy to promote and facilitate investment. All references to investment promotion agencies assume such alternative arrangements.
4. WAIPA itself was only formed in 1995.
5. UNCTAD (1999), p. 17.

6. OECD (2002a), p. 29.
7. UNCTAD (2004), p. 34.
8. Morriset (2003), p. 14.
9. OECD (2002a), p. 43.
10. *Ibid.*, p. 67.
11. UNIDO (2003), p. 66.
12. Commission for Africa (2005), p. 223.
13. UNIDO (2003), p. 50.
14. OECD (2002b), p. 136.
15. *Ibid.*, p. 101.
16. OECD (2002a), p. 34.
17. World Bank (2004), p. 172.
18. UNCTAD (2001), p. 177.
19. World Bank (2004), p. 171.
20. World Bank (2004), p. 191.
21. Within this context, trade preferences, such as the African Growth and Opportunity Act (AGOA) in the United States, and the European Everything But Arms initiative can play an important promotional role by expanding the markets to which countries benefiting from such schemes can export (which, in turn, can encourage investment). This topic is dealt with in the trade chapter of the PFI.
22. FIAS (2004), p. 20.
23. The Euromed countries include Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria, Tunisia, and Turkey.
24. Liang Dan (2003), p. 83.

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ANNEX 2.A1

The Istanbul Ministerial Declaration on Fostering the Growth of Innovative and Internationally Competitive SMEs – Excerpts

Ministers and representatives reaffirm the need to support the development of the best set of public policies that will foster the creation and rapid growth of innovative SMEs. This requires:

a) Policies and an institutional framework that contribute to a business environment that is conducive to entrepreneurship and facilitates entry, growth, transfer of ownership and smooth exit of enterprises. These should be coherent at international, national, regional and local levels and should include:

- Stable macroeconomic policies and well-designed structural policies in areas that impinge on SMEs, such as competition, international trade and investment, financial markets, labour markets and education; and, as regards developing economies, embedding private sector SME strategies in broader development strategies and poverty reduction programmes.
- Enabling regulatory frameworks, which are developed taking into account the needs of SMEs and facilitating their integration into the formal sector; tax systems that entail low compliance costs; the transparent and equitable application of rules and legislation; simple and transparent licence and permit systems; efficient bankruptcy laws and procedures; understandable and coherent product standards in world markets; clearly defined property rights; fair and reasonably priced dispute settlement procedures; and light, predictable administrative procedures.
- Laws and systems of governance that support the development and diffusion of new technologies in ways that enable and encourage SMEs to take full advantage of them, notably by strengthening the science-innovation interface; ensuring the intellectual property rights systems are coherent, easy to understand and used effectively; and promoting access to and use of quality information and communication infrastructure and promoting the enhanced security and trust in the digital economy.

b) SME assistance and development programmes which are clear in terms of their rationale, objectives and beneficiaries. These policies and programmes should be:

- Based on sound research, empirical evidence, public-private dialogue and partnerships, and evaluated regularly for effectiveness and efficiency.

- Cost-effective and designed to encourage activity that would otherwise not have taken place and help SMEs overcome the effects of market failures, without unduly distorting market structures or creating barriers to competition.
- Designed to provide support to large groups of SMEs, including micro-enterprises, for example by helping them to: improve their management skills; obtain finance on reasonable terms; increase their capacity to compete for government procurement; have access to timely advice and information; enhance their ability to take full advantage of information and communication technologies; and improve linkages with other SMEs and large firms to encourage the emergence and development of innovative clusters.

c) Policies that contribute to mobilising human resources in order to promote entrepreneurship. This involves, *inter alia*:

- Developing a culture that encourages entrepreneurship and recognises entrepreneurial success. The integration of entrepreneurship at all levels of the formal education system can facilitate this. Formal education should be complemented by learning-by-doing activities and other practical workshops. This objective requires paying close attention to teacher training programmes.
- Promoting the diffusion of training programmes and lifelong learning opportunities by stimulating market provision of such services and, where the need exists, providing hands-on focused courses funded by the private sector.