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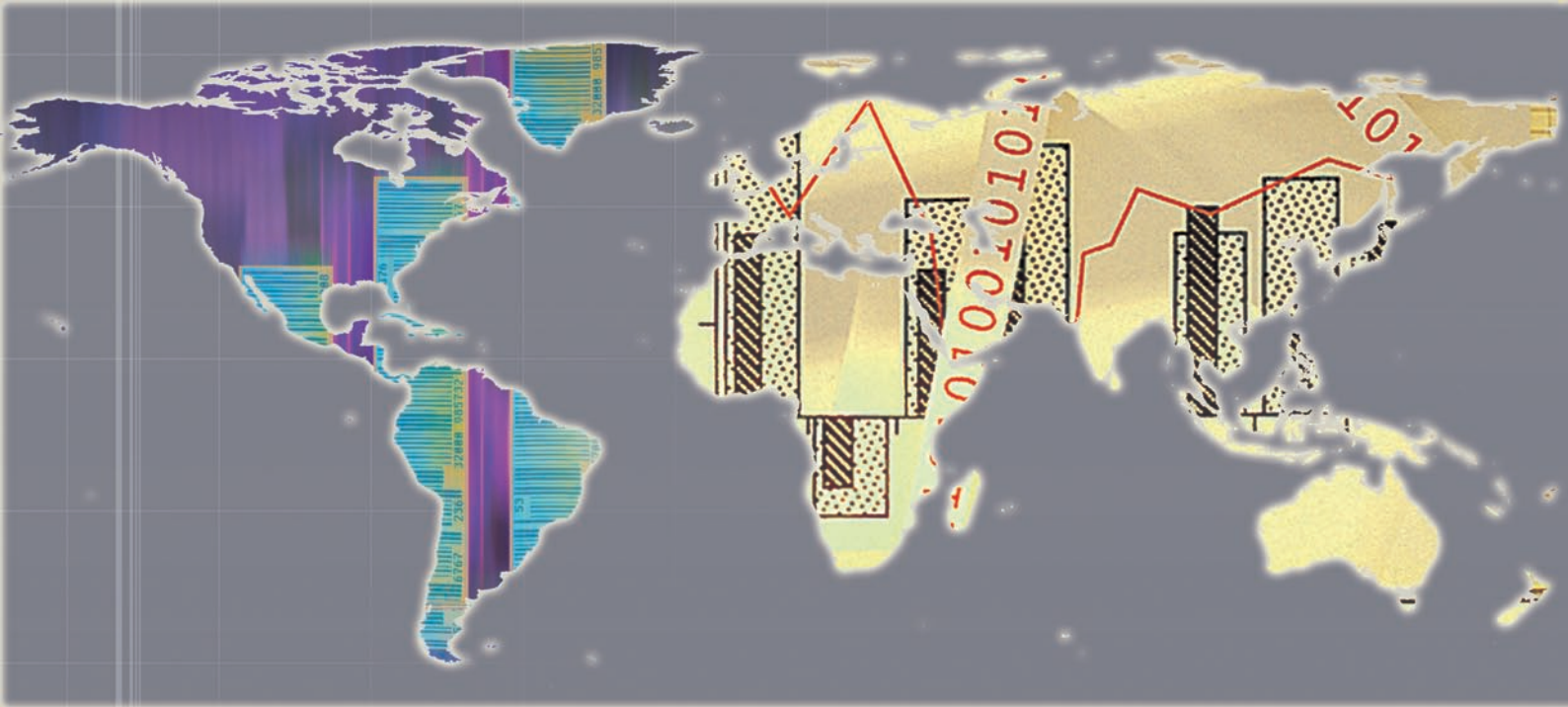
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## FDI Policy Instruments: Advantages and Disadvantages





RESEARCH AND STATISTICS BRANCH  
WORKING PAPER 01/2009

# **FDI Policy Instruments: Advantages and Disadvantages**

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Vienna, 2009

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## **List of abbreviations**

FDI	foreign direct investment
FPI	foreign portfolio investment
FTZs	free trade zones
GATS	General Agreement on Trade in Services
IP	investment promotion
IPAs	investment promotion agencies
IPPRs	intellectual property protection rights
Mercosur	Mercado Común del Sur
MNCs	multinational corporations
MNEs	multinational enterprises
PIs	policy instruments
TNCs	transnational corporations
TRIMs	trade-related investment measures
TRIPs	trade-related intellectual property rights
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
WTO	World Trade Organization



## **Abstract**

This paper delineates and discusses the growing number of factors and variables, which constitute the core of foreign direct investment policy instruments. It does so within the new context of the foreign direct investment regime and its requisite policy intervention. The range of factors and variables, their foreign direct investment elasticities and implications for policy craft as well as the policy dimensions, array of foreign direct investment regulatory, incentive, measures, trade policies and trade-related investment measures are depicted. The relative advantages and disadvantages of policy instruments are viewed through the lens of policy coherence and ‘fit’ – in spatial sequencing and switching terms – with a country’s evolving economic and temporary circumstances and conditions. The need for intense policy research and analysis is emphasised.

## Introduction

This paper, intended to provoke a debate, aims at delineating, and attempts to explain, the complexity of crafting foreign direct investment (FDI) policy instruments (PIs),<sup>1</sup> the implications for developing countries and the challenges they face in operationalizing PIs. Of particular importance is the calibration of PIs to the new context of FDI (and foreign portfolio investment (FPI)).

It is nowadays accepted that FDI plays a crucial role in industrial development of the developed and developing countries alike and can help in boosting economic growth through, for example, total factor productivity growth. FDI increasingly comprises sets of inter-connected operationalized business decisions by multinational enterprises (MNEs) in response to changing global and regional competitive, strategic considerations and factor conditions<sup>2</sup>. As such, FDI PIs, which have analytical and regulatory dimensions, are required to manage the landscape of MNEs' FDI operations in order to maximize positive externalities accruing to the host location, as well as optimizing the allocative efficiencies involved in FDI. According to UNIDO (2003), the policy framework for FDI is a crucial part of the overall national strategy for industrialization. As the ratio of inward FDI to GDP is, in general, relatively high for developing countries in comparison to industrialized countries, the role of well-designed FDI PIs in economic development cannot be overestimated.

From the outset, one needs to appreciate that when reference is made to the advantages and disadvantages of FDI PIs, it is in terms of the *relative* merits of the policy tools. It is also important to indicate that, from a policy perspective, the pros and cons of PIs are framed by considerations of who (interest groups) gains or loses. This is not a trivial issue, depending not only on the demographic structure of employment distribution of the labour force in the economy, but also on the changing nature of the relative balance of competitive advantage

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<sup>1</sup> Throughout the paper, policy instruments and policy tools are used interchangeably.

<sup>2</sup> This includes the business cycles (inventory fixed investment, infrastructural, technological) as well as major recessions such as the current recession caused by the global capital and financial crisis which became apparent in mid-2007 [although its antecedents can be traced to mid-2005 (see *The Economist*, After the fall, 18 June 2005 North American Edition)].

between countries. These two influences move at two very distinct ‘policy speeds’ – the first, in generational terms, the second, in business cycle terms.

As pointed out by UNCTAD (1996, p. 164), “the priorities and objectives of governments and transnational corporations (TNCs) differ, but their interaction is one of the fundamental dynamics underpinning economic growth and development”.<sup>3</sup> However, governments are primarily concerned with increasing welfare functions within the national economy for the benefit of citizens. MNEs, for their part, are primarily concerned with maximizing the long-term value of the firm for the benefit of shareholders (who may or may not be citizens in the economy of their FDI). These respective duties do not always coincide or converge. They can be highly cooperative and/or conflictual within firm – Nation-State economic relations (Stopford et al., 1991). The issue of policy craft for FDI (and FPI) is therefore increasingly crucial to the economic well-being of developing countries. Accordingly, PIs for shaping the economic environment in order to attract, promote and enhance inward FDI are essential tools that need to be brought into the armoury of the policy-making community. And furthermore, PIs should be aligned with the host countries’ industrial policy as well as with their general development goals (UNIDO, 2005).

Fundamentally, PIs are meant, at best, to shape – or even distort – the economic environment of the host country in order to attract and retain higher levels of value-adding FDI. This debate questions to what extent this distortion should be oriented in the sense of more liberalization or more regulation. The debate concerning whether liberalization and/or regulation of FDI PIs invokes subsidiary issues, which in turn concern the factors and variables of policy. Taxonomically these factors and variables may be grouped in terms of investment or business climate benchmarking,<sup>4</sup> Competitive Industrial Performance criteria (UNIDO, 2002; 2007), fiscal items (direct and indirect taxation) and non-fiscal items (grants, etc.). The major challenge to policy makers is that, in a world increasingly influenced by the World Trade Organization

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<sup>3</sup> In this paper, the terms MNEs, TNCs and MNCs are interchangeable, although MNEs is preferable as it is imbued with connecting the entrepreneurial capacity and capability of international firms more so than the term corporation, which harks back to the organizational rigidities of ‘Fordism’ (Lipietz, 2001).

<sup>4</sup> See A. T. Kearney (2004); Fraser Institute (2004); Heritage Foundation (2005); IMD, Corruption Perception Index (2001-2008); Transparency International [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/](http://www.transparency.org/policy_research/surveys_indices/cpi/) (2001-2008); UNDP (2003); UNIDO (2002); World Economic Forum. Global Competitiveness Report (2001-2008); World Bank (2005).

(WTO) and a ‘rules-based’ approach to policy matters, with diminishing barriers to factor mobility, the range of FDI PIs has expanded to include all the factors and variables of: (i) FDI determinants and motivations;<sup>5</sup> (ii) structural adjustment;<sup>6</sup> (iii) business operational environment;<sup>7</sup> (iv) enterprise performance;<sup>8</sup> (v) ability to do business ‘without a hassle’;<sup>9</sup> (vi) macroeconomic competitiveness;<sup>10</sup> (vii) economic freedom;<sup>11</sup> and (viii) FDI confidence.<sup>12</sup> Simultaneously, policy discretion arguably has been diminished by the ‘rules-based’ approach. In terms of competitive industrial performance, the policy factors (and variables) reflect industrial capacity and complexity.<sup>13</sup> In terms of taxation, the pertinent factors and variables of PIs cover direct (income, corporate earning taxes) and indirect (consumption and transaction taxes) fiscal measures.

The rest of the paper is organized as follows. Section 1 – The New Context of the FDI Regime – deals with the new context of international investment and the implications for policy makers. Section 2 – Background Issues on Host Policies for FDI – explains the framework for FDI promotion, presents the different policy dimensions and enumerates the various PIs. Section 3 – Key Issues for Effective FDI Promotion – addresses the issue of “regionalization” of FDI and the importance of policy coherence within and across national boundaries. Section 4 – Discussion on the Pros and Cons of FDI PIs – finally debates the relative advantages and disadvantages of FDI PIs. Concluding Remarks – concludes.

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<sup>5</sup> See Bartels and Pass (2000) for an indication of the range of motivations.

<sup>6</sup> Resource assets, infrastructure, operating costs, economic performance, governance, taxation, regulatory conditions and framework.

<sup>7</sup> Public services and policy, legal system, corruption, regulatory efficiency, mergers monopolies and competition policy, financial services.

<sup>8</sup> Regulatory capture, influence and lobbying, labour market, rule of law.

<sup>9</sup> Starting a business, hiring and firing workers, access to credit, enforcing contracts, closing a business.

<sup>10</sup> Macro-economic conditions, public institutions, technology.

<sup>11</sup> Trade policy, fiscal burden of government, government intervention in economy, monetary policy, FDI and FPI, banking and finance, wages and prices, property rights.

<sup>12</sup> Propensity of firms to undertake FDI in a particular location.

<sup>13</sup> In a country’s Industrial Capability Profile, this comprises manufacturing value added per capita in conjunction with manufactured exports per capita; and share of medium and high technology (MHT) in MVA in conjunction with share of MHT in exports. The first pair of indices indicates industrial capacity and competitiveness, whereas the second pair connotes industrial depth and complexity. See UNIDO (2002).

## **1. The New Context of the FDI Regime**

Taking departure from the 2005 UNIDO expert group meeting working paper – The Evolving Nature of FDI Industrial Organization and Challenges for Policy and Practice<sup>14</sup> – it is clear that FDI and its transforming (and transacting) relations are the predominant integrating factors of the global economy. To put this integrating phenomenon of FDI (and its associated stock) into perspective, it is worth pointing out that FDI inflows in 2005 at US\$916 billion represented about 10 per cent of global gross fixed capital formation while inward FDI stock at US\$10,130 billion was about 23 per cent of global GDP at 2005 current prices. Furthermore, according to UNCTAD (2006) the total sales of foreign affiliates at US\$22,171 billion represents about 50 per cent of global GDP, while the ratio total assets of foreign affiliates to global GDP is US\$45,564 billion to US\$44,674 billion. This structural change to the pattern of economic activity presents a fundamentally new context for policy and practice regarding the rules, incentives, laws, promotional mechanisms and strategies necessary to capture and retain FDI. The new context holds implications for policies necessary to change the type of FDI that flows to a particular developing country or region.

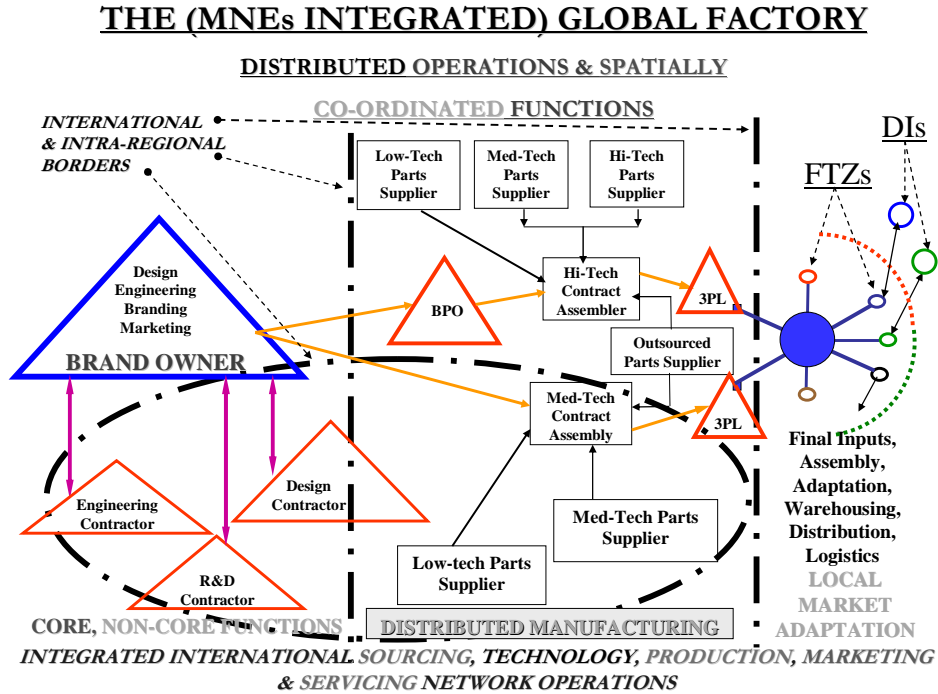
While the process of economic globalization and its constituent elements are constantly co-evolving, there are several dimensions concerning the new context of FDI that policy makers in developing countries need to be increasingly aware of. First, MNEs are nowadays adopting a different mode of organization for their production, functions and operational activities, which can be called ‘the global factory’ (UNIDO, 2005). This is stylistically illustrated in figure 1 below.<sup>15</sup>

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<sup>14</sup> Working Paper for UNIDO Expert Group Meeting on The Evolving Nature of FDI Industrial Organization and Challenges for Policy and Practice, Bangkok, Thailand, 21-23 March 2005.

<sup>15</sup> It should be noted that while each MNE has its own ‘global factory’, inter-firm relations mean that several ‘global factories’ are involved in the production of any one good.

Figure 1. The Global Factory



Source: Bartels (2009) adapted from Buckley (2003).

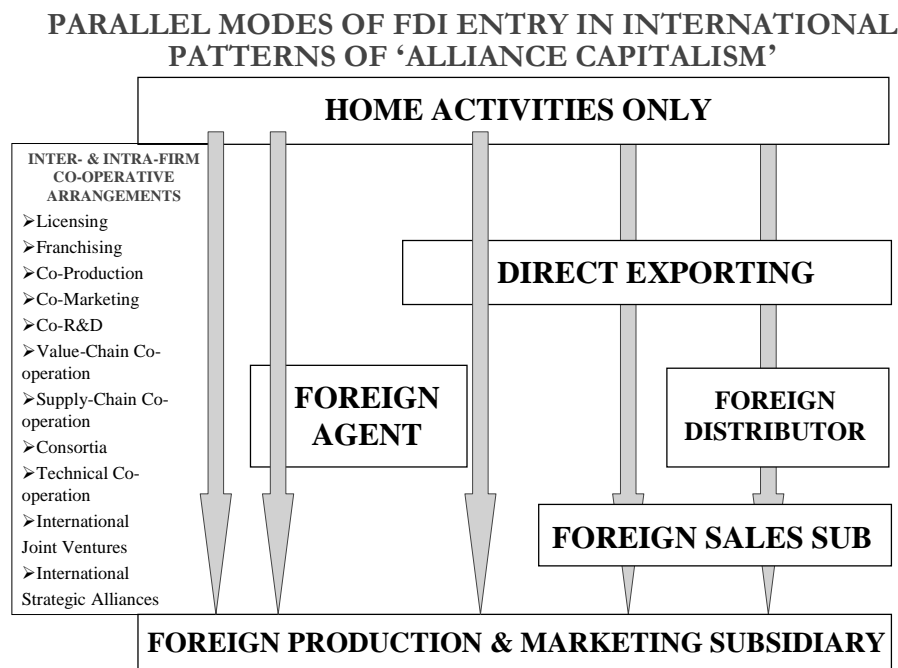
‘The global factory’ is co-evolving with the policy environment and the MNE organizes its global production through spatially coordinated functions. This is characterized by interchangeability and is in dynamic tension with its internal constituents, as well as external forces of competition and cooperation. This context and process are highly complex and their comprehensiveness, with respect to intra- and inter-firm transactions, requires attention by policy makers. The understanding of this phenomenon appears to be extremely necessary for host countries in order to put in place effective FDI policies. There is indeed an increasing need for the host policy environment to reflect ‘the global factory’ of MNEs.

In addition, policy makers have to bear in mind that, while the global strategies of MNEs are evolving and manifest in the configuration and reconfiguration of the ‘global factory’, the previous separated patterns of FDI by firms (in sequential time and place and, hitherto, more predictable modes of entry) have been replaced by parallel modes of entry in multifaceted

international patterns described as ‘alliance capitalism’ (which includes joint ventures, strategic alliances, co-production and marketing, co-research and development (R&D), contract design and manufacturing with equity and non-equity formalities). This is stylistically illustrated in figure 2 below.

In this context, policy makers need to move beyond the idea of attracting FDI with the lure of cheap labour and unsophisticated tax incentives.<sup>16</sup> These new operational patterns of FDI are characterized by international networked systems of industrial sourcing, technology, production, marketing and servicing, and place a serious challenge on policy-making in the developing world. Economic and industrial policies of the host countries have to be both appropriate and well sequenced if they want to succeed in capturing the kind of FDI that would boost their industrial development.

**Figure 2. Parallel Modes of FDI Entry in International Patterns of ‘Alliance Capitalism’**



Source: Adapted from Newbould, Buckley and Thurwell (1978).

<sup>16</sup> The productivity adjusted cost of labour skills, and the credibility and predictability of the tax system (both direct and indirect), inter alia, is what is increasingly taken into account in location decisions of MNEs.

These policy issues are related to the increasing trend of the spatiality in FDI (Blonigen et al., 2004). In other words, MNEs not only consider home and host country characteristics when they decide to invest, but also third locations. In fact, there is a spatial correlation between FDI in a particular country and in alternative countries or regions. There is empirical evidence that regions surrounded by large markets tend to attract more FDI.<sup>17</sup> It is worth mentioning that third locations acquire significance in MNEs' decision-making, especially when their investments deal with vertical integration, as they will be motivated to take advantage of the comparative advantages of different locations. Since FDI decisions are multilateral and multivariate by nature, the interdependence between host destinations is gaining magnitude in MNEs decision-making and hence should be increasingly factored into the crafting of developing countries' PIs as well as their implementation.

Finally, an additional element that is arguably having a radical impact in the new context of economic globalization, and FDI in particular, is the set of international laws agreed to by signatories of, and imposed by, the World Trade Organization (WTO).<sup>18</sup> Although these laws are primarily dealing with international trade, they are also obviously related to issues of international investment (although not as comprehensively). The major framework affecting FDI PIs within the WTO rules is the trade-related investment measures (TRIMs), but other agreements, such as the General Agreement on Trade in Services (GATS), the Agreement on Subsidies and Countervailing Measures and trade-related intellectual property rights (TRIPs) also address foreign investment issues (WTO, 2005). In fact, these agreements emphasise that some investment measures are discriminatory, restrict and distort international trade and should therefore be eliminated. This is an imperative issue for developing countries, as they have to design their FDI regime, and PIs therein, in accordance with the WTO rules, considered internationally as 'hard law'. These considerations constrain the degrees of freedom available to policy makers and require higher order policy research and analysis in relation to competitiveness and trade analysis to generate valid PIs.

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<sup>17</sup> This carries major implications for PIs and FDI law operationalised at the regional level and various dimensions of FDI policy, which exploit differentiated factor conditions and costs across the geo-economic space of the region. In addition, robust regional institutions are crucial to workable PIs.

<sup>18</sup> In this regard, it is important to note 'actionable' and 'non-actionable' subsidies in the framework provided by the WTO.



However, at the same time as the WTO agreements have reduced the room for manoeuvre of national governments regarding FDI policies, they also have diminished tremendously the barriers to international investment, making the task easier for investors and, by definition, host countries – given conducive business climates (UNCTAD, 2003). Thus, one can say that both MNEs and governments of industrialized countries tend to be favoured by the ‘hard law’, whereas host governments in developing countries in general, and least developing countries in particular, tend to have their bargaining positions significantly constricted. This makes the task of crafting PIs for FDI extensively more difficult for developing countries, as they are most often only importers of FDI. In contrast, industrialized countries tend to have a more balanced position, as they are the major sources of, and hosts to, FDI.

Thus, policy makers in developing countries, like their counterparts in industrialized countries, have to adapt their policy tools to the new context of the FDI regime. They need to bear in mind not only the changing strategies and decision-making process of MNEs as well as the international rules of the WTO that are reducing the scope for policy schemes, but also the competing policy and strategies of other FDI host locations.

## **2. Background Issues on Host Policies for FDI**

The growing importance of well-crafted PIs for FDI is illustrated by the increasing numbers of foreign investors – nation-State disputes being formally registered at the ICSID.<sup>19</sup> This contestation reflects the issue of risk in a rules-based investment and trading environment, and the extent to which good policy and excellent implementation can reduce disputes and thereby also reduce the risk associated with doing the business of investing in a particular location. It is crucial to note that all bar-one dispute claims have been lodged by investors; and of the claims, 39 (that is, 78 per cent of total defendants) are against governments of developing countries. These claims are costly in legal terms and also adversely affect the image of the host location at a time when the host country Investment Promotion Agency (IPA) may be attempting to market the country and/or target specific investors for strategic sectors of the economy. Given the

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<sup>19</sup> The International Centre for Settlement of Investment Disputes of the World Bank, where registered disputes have increased from three (1994) to 106 (2004) with an additional 54 cases outside the ICSID, according to UNCTAD (2004).

increasing rules-based system, shrinking discretion and widening coverage of PIs within bilateral investment treaties, double taxation treaties, regional trade agreements, and international investment agreements, it is likely that formal disputes over FDI policy and application of PIs are set to grow in number and legal complexity.

Furthermore, from a PIs perspective, FDI and FPI have to be increasingly considered in tandem, albeit in a sequential manner for policy-switching purposes. The stimulation of FDI and FPI inflows depends on the design (and reform) of PIs (Reisen, 2001). With respect to the widening coverage of PIs, this is due in part to the complexity inherent in the operations of ‘the global factory’ and partly due to the rising popularity and availability of business and investment climate benchmarking.<sup>20</sup> These benchmarking publications cover a vast array of variables, which in concert depict the comparative characteristics of the economic effectiveness and competitive efficiencies of various countries. Clearly, from a policy craft and PIs perspective, attention to a country’s relative position in these benchmark ‘league’ tables is crucial not only for steering policy but also for assessing the relative validity and success of policy and PIs. This is further explored below. But before examining the relative ‘advantages’ and ‘disadvantages’ of PIs, it is germane to look at the framework for, and policy dimensions of, FDI (and FPI).

#### A. *The Framework for FDI PIs and Promotion*

According to Loewendahl (2001), the framework for cradling the PIs of investment promotion (IP) can be divided in four major areas: strategy and organization, lead generation, facilitation and investment services. All include several stages to be crafted and instruments to be applied for effective FDI promotion in an integrated manner. In the field of strategy and organization, the different stages are: (i) setting the national policy context, which requires inter-ministerial coordination; (ii) setting the objectives; (iii) deciding on the structure for operating IP; (iv) implementing a competitive positioning exercise (strategic direction and effective marketing);

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<sup>20</sup> Unpublished UNIDO Research on *Policy Determinants of National Innovation Systems* examining policy factors and variables scored by various institutions.

and (v) executing a sector targeting strategy.<sup>21</sup> In the next area – lead generation – the stages are (vi) marketing, which aims at increasing the awareness of investors; and (vii) company targeting. In the area of facilitation, the stage is (viii) pre-project management and project handling, which aims at converting an investment proposition and investigation into an actual investment. Finally, the last two stages in the area of investment services are (ix) after-care and services improvement; and (x) monitoring and evaluation. Loewendahl thus draws a clear and precise framework of 10 different stages to be implemented by host countries, albeit adapted to local circumstances and conditions, for effective IP. However, each country needs to calibrate the 10 stages to its overall industrialization objectives, as well as resources available and its evolving stage of development.

By taking a broader perspective on FDI PIs and promotion, it is acknowledged that there are three generations of IP (UNCTAD, 2002). The *first generation* of IP emphasises opening the economy to FDI. The *second generation* is for a government to decide to actively “market” its economy, namely, by putting in place a board of investment or an IPA.<sup>22</sup> Most developing countries have moved from the *first* to the *second* generation of FDI promotion, while, several host countries have moved towards a *third generation* of IP by targeting more specific investments. Indeed, IPAs have to change from too narrowly focused promotion strategies in order to increase the efficiency of FDI, by capturing various stages of export-oriented investment, for example. A targeted approach can better help developing countries to complement and achieve strategic objectives of development and use resources efficiently. However, whereas this *third* generation of IP is probably more successful for boosting a country’s industrial development, it also constitutes a much more complicated task for policy makers, since knowledge of FDI issues and implications need to be particularly advanced.

Going a step further, it is suggested that developing countries put in place mechanisms that allow them to move to a *fourth* generation of IP, where IPAs should adapt their strategies to the new complexity of MNEs, as described in the previous section (UNIDO, 2005). The *fourth* generation

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<sup>21</sup> Bearing in mind the need to move rapidly through first, second, third- to fourth-generation investment promotion strategy and organization needs to take into account the wider macro-economic setting, which progressively reduces the transaction costs of doing business (World Bank, 2005).

<sup>22</sup> In recent years, the establishment of formal IPAs has gathered sufficient momentum such that the number of national IPAs had increased to 158 by 2004 (UNCTAD, 2004 and UNIDO, 2003).

of FDI promotion can be characterized by a reduced distinction between domestic and foreign investment activity in policy terms. In fact, some governments have a special policy framework for foreign investors, which is different to that for domestic investors. However, the trend is to eliminate damaging arbitrage and distortions by having the same, or at least similar, policies for local and foreign investors. Although in the short to medium term a separate policy environment for foreign investors may be the only option if these investors are to be attracted, experience suggests it would be best to have a uniform policy environment for both groups (UNIDO, 2003). Therefore, the thorny issue of ‘incentives’ should be addressed by focusing on information and communications technology (ICT) infrastructure, human resource development and social capital formation; and positioning strategic domestic sectors and subsectors within the interstices of ‘the global factory’ and networks of MNEs.

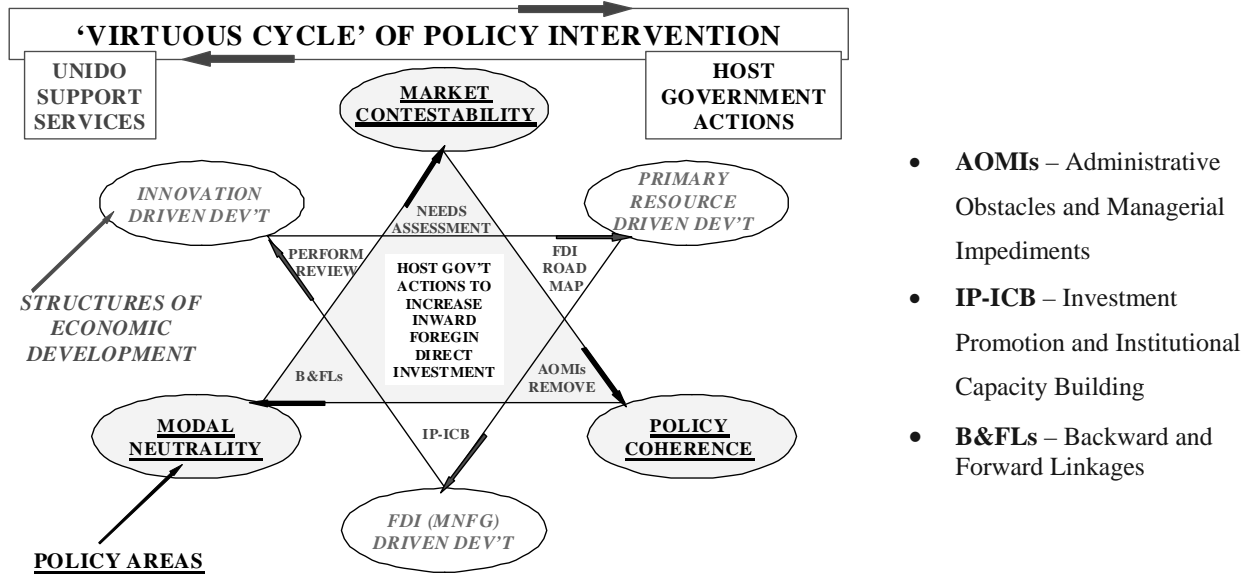
Depending on the level of industrial development, different countries need to improve different aspects of their policy environment, at different times, for attracting FDI. Figure 3 – The ‘Virtuous Cycle’ of policy intervention – illustrates the inter-connection of the key aspects of the policy framework given by modal neutrality, market contestability and policy coherence,<sup>23</sup> and managed by host government, as well as the predominant characteristic structure that drives economic development<sup>24</sup> and the host government-specific actions to increase FDI which can be supported and reinforced by UNIDO enabling services (UNIDO, 2003).

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<sup>23</sup> Modal neutrality describes policies that allow foreign investors to decide for themselves how best to serve the markets they enter. Market contestability embodies the ability of both foreign and domestic investors to compete on a level of playing field for the factors of production. Policy coherence refers to the degree of internal consistency of objectives, FDI policies and interpretation of policies, in their regulatory form, across a range of issues and at different level of government.

<sup>24</sup> See stages of Competitive Development in UNIDO (2000).

Figure 3. The 'Virtuous Cycle' of Policy Intervention



Hence, from a broad perspective, for example, countries with economies considered predominantly dependent on the primary sector should place greater emphasis on needs assessment and road mapping so that they can look for possibilities to minimize the investors' time and costs, and eliminate or reduce administrative obstacles and managerial impediments. Economies that are predominantly dependent on the commodity resources primary sector would need to place policy emphasis on the regulatory frameworks that moderate ownership rights, land acquisition protocols and the whole system of property rights and transaction laws. Manufacturing-driven economies might want to place more emphasis on direct IP and consider institutional capacity-building after demonstrating significant progress on the removal of administrative obstacles and managerial impediments to FDI. In a predominantly manufacturing-driven development, the host government might wish to focus greater attention on fostering backward and forward linkages. Policy emphasis should focus on intellectual property protection rights (IPPRs), as the core dimension of manufacturing is production know-how and technology know-why. Innovation-driven economies might want to place emphasis on higher levels of performance review, while focusing attention on reinforcing integration and linkages. The needs

assessment for innovation-driven development is of immense strategic importance with respect to technology futures.

The areas of greatest significance for crafting PIs, in terms of fourth generation IP, are therefore:

- i. Policy needs assessment. It is important for policy makers in developing countries to have an accurate view of the policy needs of the country – as a host to FDI – in relation to overall industrialization. For example, PIs may have inadvertent biases or may be inoperable in the practical terms of doing business – thus creating ‘gates’ for rent-seeking activities. Given the global factory of MNEs, there may be a need to revise legislation, in the light of WTO provisions, regarding joint ventures, for example. A policy needs assessment exercise provides policy makers with a measure of the policy areas requiring attention.
- ii. FDI road mapping. In other words, it is important to ensure that the IPAs and policy makers in developing countries are fully aware of the actual ‘on-ground’ details of making a FDI in terms of requirements and legal process.
- iii. Administrative obstacles and managerial impediments and their removal in transparent, and legislatively predictable, phases. This policy area and its instruments reflect the factors and variables enumerated in Doing Business (World Bank, 2005).
- iv. IP and institutional capacity-building which concerns the capability of the relevant authorities, including IPAs, to engage with foreign investors in a manner that results in better quality FDI inflows. And growing commitment by MNEs to locating increasingly parts of the vertical specialization of their FDI in the country. This policy area also deals with surveys and the reporting formalities on FDI intentions that permit IPAs to fine-tune PIs and measures. It also allows IPAs to develop a forward-looking posture with respect to the likely reconfiguration of the operations of key foreign investors in their economy.

- v. Backward and forward linkages to domestic industry investment. This policy area for FDI concentrates on PIs relevant to enabling domestic industrial sectors to integrate into the international production networks of MNEs. PIs therefore need to be oriented towards supporting collaborative forms of MNEs engagement with domestic industry through, for example, joint ventures with promising local firms; local company technological and managerial upgrading schemes; and infrastructure provision via public-private partnerships that improve the efficiencies of intermediation (value-added distribution and logistics).

In respect of PIs in this area, two key observations are necessary. First, infrastructure that enables intermediation raises total factor productivity but in a manner that varies across industries. Secondly, infrastructure is correlated with the composition of output in terms of the pattern of international industrial specialization. Therefore, PIs in this area increase the incomes of factors used intensively in manufacturing (Yeaple and Golub, 2002).

- vi. The performance review of PIs operationalized by law and implemented by IPAs in IP is crucial to maintaining the relevance of the framework for cradling the PIs for FDI. An essential part is surveying the impact of PIs on investor choices regarding motivations, and entry/exit strategies across industrial sectors, as well as MNEs propensities for collaborating with domestic firms. It goes without saying that the relationship of these choices to incentives, which is measured through surveying, is vital to policy craft.

### *B. The Policy Dimensions*

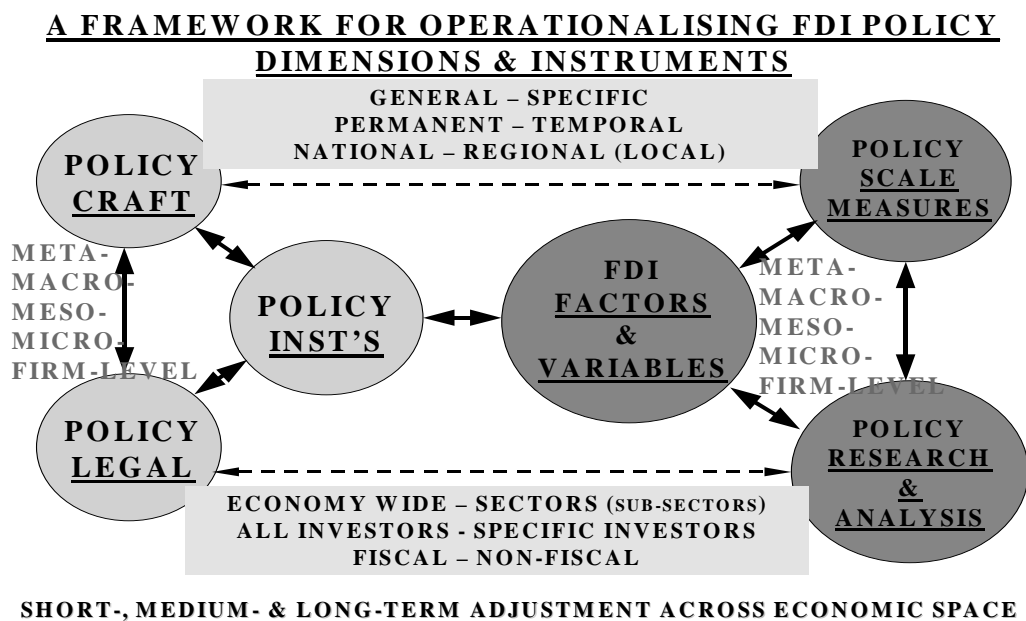
An analysis is now made of the different FDI policy dimensions in which PIs are made to be implemented by host countries. It is important to note here that governments of developing countries choose PIs – generalized as incentives<sup>25</sup> – to attract FDI in relation to their overall economic development goals. Thus, different dimensions of incentives can be depicted. First, incentives can be either *general* or *specific* (with a discretionary perspective). A second dimension is the durability of incentives. Indeed, according to the host country's priorities,

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<sup>25</sup> Not to be confused with the special category of incentives named fiscal or financial incentives.

incentives could be either *permanent* or *temporal*. However, pragmatically speaking, PIs related to incentives need to change in duration so as to encourage the kinds of FDI and industrial specialization the country desires. And therefore it is useful to think of these PIs as windows of opportunity which open and close. Another dimension exists at the geographic – or spatial – level since IP policies can target FDI either at a local, *national* level or *regional* level. Local incentives can be used to promote specific regions of a country that are poorer or in greater need of development. Further, incentives can be used to attract foreign investors to the whole *economy* or only to certain *sectors* or subsectors, according again to the specific needs of the country. In the past, this has carried the rubric ‘negative’ or ‘positive’ lists which cordoned off strategic sectors of the economy to foreign investors and reserved others for national firm.<sup>26</sup> Finally, at the firm level, incentives can focus either on *all FDI*, or only on *specific investors*. These dimensions are depicted in figure 4, A Framework for Operationalizing FDI Policy Dimensions and Instruments.

**Figure 4. A Framework for Operationalizing FDI Policy Dimensions and Instruments**



<sup>26</sup> See Ostrovsky and Morrison (2005) for a contemporary illustration of this phenomenon.



To say that policy craft – creating policy coherence out of the conflicting demands from modal neutrality, market contestability, as well as scaling and measuring the factors and variables which must be considered in policy research and analysis – is a challenge, is an understatement. This paper makes early reference to the growing importance of investment and business climate benchmarking as a guide to policy-making. However, econometrically, as every factor or variable (or their combinations) has its own FDI inflow- and stock-elasticity, IPAs and policy makers with limited resources should concentrate their policy craft on those FDI factors and variables with the highest FDI-elasticities (Christiansen, 2004).<sup>27</sup> In rank order, these are: (i) growth-competitiveness, which combines macroeconomic and technology variables, with an FDI inflow elasticity of 0.63; (ii) economic freedom, combining government intervention, property rights, wages/prices and regulation variables, with an FDI inflow-elasticity of 0.56; (iii) taxation and regulation with an FDI inflow-elasticity of -0.50; (iv) quality of telecommunication services with FDI inflow-elasticity of -0.28;<sup>28</sup> and (v) labour market regulation with FDI inflow-elasticity of -0.26. Furthermore, these elasticities have short- medium- and long-term adjustment rates. This approach begins to lay out the choices available to policy makers in making viable PIs in a systematic manner based on rigorous analysis. Hence, from a fourth-generation IP perspective, a focus on the macroeconomic environment stability and technology policies to increase the rates of innovation and transfer by PIs that facilitate licensing and franchising, for example, would be needed. In a similar vein, harmonizing taxation regulation across regional space would be a viable policy.

All these elements and issues in figure 4 reflect the need for sequencing and switching PIs and incentives, both in space and time. In other words, while FDI policy-making is increasingly more complex and diverse, host governments, according to their development needs, have to adapt to the MNEs dynamic activities by sequencing and switching (in a predictable manner) their FDI PIs. Moreover, these different policy dimensions also indicate the importance for host governments to create different levels of policies: the meta- or supra-national level, the macro or

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<sup>27</sup> For example, the FDI stock elasticities of GDP per capita range from 0.89 to 0.96 implying that a 10 per cent increase in a country's GDP per capita would result in a 10 per cent increase in inward FDI stock. Likewise, the FDI inflow-elasticity of a host country's competitiveness (scaled 1 to 5) at 0.63 implies that an increase of 1 point in the scale would result in an increase of 88 per cent inward FDI ceteris paribus. See Christiansen (2004) for other FDI-elasticities (economic freedom, taxation, regulation, infrastructure, human resources).

<sup>28</sup> The measurement scale is from 1 to 5 representing increasing poor quality, hence the negative sign on regression coefficient.

national level, the meso or regional and cluster level, the micro or industrial sector and subsector level and the firm level of organizational strategy and competitiveness (UNIDO, 2005). The complexity of FDI host policy-making is obvious but the policy dimensions have to be chosen and established in harmony with the general development goals set up by the government.

Ultimately, it could be argued that all these dimensions collapse into one dimension regarding incentives. In fact, incentives can be fiscal or non-fiscal (Oman, 2000; UNIDO, 2003), as selectively illustrated in the table 1 below. As can be observed, non-fiscal incentives are constituted by financial and non-financial incentives.

**Table 1. Fiscal and non-fiscal incentives**

Fiscal incentives	Non-fiscal incentives
Tax holidays	Depreciation methods
Tax-free imports	Development Banks' loan policies
Tax exemptions	R&D support
	Environmental standards support
	Labour training support
	Government subsidies

Whereas industrialized countries typically utilize financial incentives, such as grants, developing countries usually use fiscal incentives, such as reductions in the base rate of corporate income tax, tax holidays and import-duty exemptions and drawbacks (Oman, 2000). Incentives are widely used to attract MNEs and thus create a climate of policy competition for FDI. Fiscal incentives might be successful for attracting MNEs, but incentives-based competition also creates some problems. Indeed, the first problem of incentives is that they represent opportunity cost of resources to host governments. Secondly, there can be a significant lack of transparency regarding incentives, which leaves space for corruption and other kinds of rent-seeking behaviour. Finally, given the dimension choices in figure 4, incentives also provoke market distortions. Among them, the major ones are the fact that incentives tend to favour large corporate investors to the detriment of small ones, as well as foreign over the domestic firms because of their lower risk profile and higher bargaining power. The distortion would tend to

disappear (over time) in countries adopting fourth generation of IP, as they would treat foreign and domestic firms equally with regard to incentives.

### *C. PIs*

It is noteworthy now to take a closer look at the actual PIs that exist for attracting, promoting and accompanying FDI. It is important to bear in mind that the design and the implementation of policies first depend on the actual PIs, as they are enumerated hereafter. Secondly, they should be converted into law. In fact, it is the country's law that is the highest authority for attracting, or guiding and shaping, inward FDI and it is of crucial importance that all policy tools are translated into national laws. However, the legislative aspect is beyond the scope of this paper. Table 2, adapted from various sources (UNCTAD, 1996), shows the different PIs and regulatory measures possible that are related to: (i) admission and establishment, (ii) ownership and control, (iii) the actual FDI operations, and (iv) the main incentives offered to foreign investors. However, space does not permit an exhaustive individualized examination of the pros and cons of each policy instrument here. A more general discussion follows.

The advantages and disadvantages of FDI PIs arise not in absolute terms but relatively from the way they are calibrated and recalibrated and applied in changing circumstances. For example, regarding ownership, a primary resource-driven economy would need high modal neutrality to enable wholly-owned subsidiaries (as the likelihood of local firms able to joint venture meaningfully would be low) and have PIs that secure property rights. It would be disadvantageous to insist on FDI policy that requires joint ventures between MNEs and local firms in order to invest in vertically specialized minerals production. Regarding capital depreciation, as another example, policies need careful calibration or else intended beneficiaries might not actually alter their capital/labour ratios and the capital intensities needed to upgrade the technological capacity of the manufacturing sector.

**Table 2. FDI Regulatory Measures and Incentive Measures**

Admission and Establishment Regulatory Measures	Ownership and Control Regulatory Measures
<p>Sectors ring-fenced from FDI            Quantitative restrictions on numbers of MNEs            Minimum capital requirements            Subsequent additional capital inputs            Screening, authorization, registration            Entry conditions – Meeting criteria (environment)            Legal form requirements of FDI            Restrictions on entry modalities (MAs, IJVs, ISAs)            Special requirements for non-equity (BOT, IJVs, L/F)            FDI to specific locations (moderate urban drift)            Restrictions of imported input factors            Deposit requirements prior to FDI            Admission to hosts privatization deals restricted            Admission and incorporation fees (taxes)            Compliances with norms (national security, customs, public morals)</p>	<p>Equity limits on foreign ownership (e.g. less than 50 per cent)            Entry modalities limited to IJVs/ISAs, L/F            Mandatory transfer of ownership (Fade-outs)            Nationality limitation on equity held            Restrictions on use of foreign loans (bonds)            Restrictions on stocks and share types held by foreign investors (non-voting)            Restrictions on types of share transfers            Restrictions on foreign share holders (dividend, capital)            ‘Golden’ shares held by host (prevent MAs)            Government appoint reservations to board            Restrictions on nationality of directors            Government reserves the right to veto certain decisions            Government reserves rights to be consulted prior to decisions            Restrictions on land rights transfers            Restrictions on IPPRs</p>
Operations Regulatory Measures	FDI Incentive Measures
<p>Employment restrictions on foreign staff            Performance requirements (<i>local</i> sourcing, content, mfg, tt, employment, training, import, export, Vols, BOP, Sales, foreign exchange earnings)            Restrictions on public procurement (MNEs excluded)            Restricted access to local factors inputs, on OPs relocations within host            Restrictions on diversification, on access to communications, on free flow of government data            Operation restriction on public utilities (price control)            Restrictions on access to local credit, foreign exchange, on capital repatriations            “Cultural” restrictions            Information disclosure requirements            Special restrictions on sector operations (banks)            Operational permits and licenses, technical standards, royalty ceilings            Advertizing restrictions on foreign MNEs</p>	<p><b>Fiscal Incentives</b></p> <ul style="list-style-type: none"> <li>▪ Reductions in corporate tax rates &amp; tax holidays</li> <li>▪ Losses against future profits</li> <li>▪ Accelerated capital depreciation</li> <li>▪ Investment/reinvestment permits</li> <li>▪ Lower social security payments</li> <li>▪ Tax reductions based on staff and marketing expenses</li> <li>▪ MVA-based incentives: Local content based tax reductions</li> <li>▪ Import-based incentives: Duty exemptions; tax credits (on materials)</li> <li>▪ Export-based incentives: Duty exemptions; preferential tax on export incomes; tax reduction on foreign exchange; tax reductions on export performance</li> </ul> <p><b>Financial Incentives</b></p> <ul style="list-style-type: none"> <li>▪ Direct subsidies and subsidized loans</li> <li>▪ Loan guarantees and public venture capital availabilities</li> <li>▪ Guaranteed export credits and Government insurance at low rates</li> </ul> <p><b>Other Incentives</b></p> <ul style="list-style-type: none"> <li>• Subsidized dedicated infrastructure, services, government contracts</li> </ul>

Source: UNCTAD (1996) World Investment Report: Investment, Trade and International Policy Arrangements, pp. 176-180.

Table 3 below shows on the one hand, the trade policies, and on the other hand, the trade-related investment measures (TRIMs) as well as their impact on FDI.

<b>Table 3. Trade policies and trade-related investment measures (TRIMs)</b>	
<b>Trade policies</b>	
<b>Import policies</b>	<b>Export policies</b>
Tariffs	Fiscal incentives
NTBs (Non-tariff barriers)	Export credits and guarantees
Import quotas (voluntary export restraints e.g. Japanese autos)	Export targets
Import licenses	Overseas export promotion agencies
Import deposits	Export processing zones or free trade zones
Import surcharges	Ban on strategic exports
Anti-dumping	Exchange rate manipulation
Special labelling	
Health and safety	
Customs procedure	
Excise documents	
Subsidies to home producers	
Local content requirements	
Government contracts	
<b>Trade-related investment measures (TRIMs)</b>	
<b>Trade measures</b>	<b>Impact on FDI</b>
Tariffs, import quantitative restrictions	Induces import substituting FDI
Regional free trade agreements	Promotes FDI in member countries
Rules of origin	Induces exports oriented FDI
Export processing zones	Induces export replacing FDI
Export controls	Shifts sector balance of FDI
Export financing	Induces import substituting FDI
Non-monetary trade agreements	
Safety, health and national standards	

Source: UNCTAD (1996) World Investment Report: Investment, Trade and International Policy Arrangements, p. 181.

Table 4 (UNIDO, 2004) is a good illustration of the effects of PIs used by host countries on FDI and on market imperfection. It shows that sometimes FDI inflows and a perfect market coincide, but at other times, they are in contradiction. Thus, it is interesting to note that developing countries occasionally have to use policies that distort the market in order to attract foreign investment.

The analytical challenges of policy formulation and dynamic reconfiguration of PIs presented in tables 2, 3 and 4 are not to be underestimated (UNIDO, 2004). For example, incentives such as subsidized loans can alter the ratio of foreign to domestic in the capital structure of the FDI and hence the relative volumes of foreign to domestic investment. The FDI motivations referred to earlier therefore need to be appreciated as being amenable to amplification by the policy prescriptions of developing country hosts. However, whatever the changes in PIs, they need to be set in the trilateral policy framework of modal neutrality, market contestability and policy

coherence. Signalling changes in policy would need to be well timed, transparent and consistent with overall industrial development goals.

**Table 4. Comparative Policy Effects on Market Imperfections and Inward FDI, adapted from Brewer (1993)**

Effect on FDI	Effect on market imperfection	
	Increase	Decrease
<b>Increase</b>	<ul style="list-style-type: none"> <li>▪ Protectionist import policies</li> <li>▪ Weak IPPRs</li> <li>▪ Subsidies on in-FDI</li> <li>▪ Undervalued exchange rate</li> <li>▪ Weak competition policy</li> <li>▪ Procurement discrimination vs. foreign (non-domestic) firms</li> <li>▪ Technical standards</li> </ul>	<ul style="list-style-type: none"> <li>▪ Liberalization of FDI regime</li> <li>▪ Privatization</li> <li>▪ Foreign exchange convertibility</li> <li>▪ Anti-dumping policies</li> <li>▪ Import duties on subsidized exports from other countries</li> <li>▪ National treatment</li> <li>▪ Strong competition policy</li> <li>▪ Tariff debates on imports for export oriented FDI</li> <li>▪ Liberalization of trade restrictions</li> </ul>
<b>Decrease</b>	<ul style="list-style-type: none"> <li>▪ Overvalued exchange rate</li> <li>▪ Restrictions on in-FDI</li> <li>▪ Price controls</li> <li>▪ Import restrictions on FDI inputs</li> <li>▪ Export controls on FDI outputs</li> <li>▪ Restrictions on capital access</li> <li>▪ Restrictions on capital repatriation</li> </ul>	<ul style="list-style-type: none"> <li>▪ Strong anti-monopoly policy enforcement</li> <li>▪ Strong arm's length transfer pricing policy enforcement</li> </ul>

### 3. Key Issues for Effective FDI Promotion

Once comprehensively aware of the complexity of the framework for FDI promotion as well as the various policy dimensions and the different PIs themselves, policy makers from developing countries need to pay attention to two critical issues that enable effective IP. On the one hand, there is the increasing influence of regional-integration agreements on international investment and their implications for FDI promotion and, on the other hand, the importance of coherence and consistency, both at policy and legal levels.

#### A. *The “Regionalization” of FDI*

The “regionalization” process of FDI is a phenomenon with increasing importance. Historically, international rules and agreements have mostly dealt with trade more than with international investment. However, due to the fact that trade issues are gradually more concerned with domestic PIs, the divergence between international trade and international investment is

becoming less and less prominent (UNCTAD, 1996). Therefore, international free trade agreements nowadays actually correspond to free trade and investment agreements.

Regional-integration agreements between two or more countries are among of the most powerful means to attract FDI. These agreements have dramatically increased since the mid-1980s, the most significant being North American Free Trade Agreement, Mercosur, Association of South East Asian Nations and the European Union, with a single market since 1985. These regional agreements promote FDI as they facilitate more investment among the member countries but they also promote FDI from outside the region or agreement. Indeed, the first reason why regional agreements attract MNEs is because they create larger markets. Secondly, the establishment of these regional-integration agreements also implies a greater degree of market deregulation within member countries, which attracts MNEs from outside. Thus, regional agreements not only promote more intra-regional investment but also FDI from outside. One can argue that in the case of the North American Free Trade Agreement, the third-country location thesis is prominent since many MNEs (mostly from Western Europe and Japan) are interested in investing in Mexico in order to penetrate the markets of the United States and Canada.

Finally, it is worth mentioning that regional-integration agreements also constitute an excellent means to decrease the 'race to the bottom' incentives-based competition and its negative consequences. In fact, one may argue that most of the policy competition among host governments occurs within, rather than between, regions. Therefore, regional agreements have a great potential to improve the cooperation among host governments to regulate and harmonize their use of PIs and fiscal and financial incentives and thus to limit the harmful effects of excessive policy competition.

Regional-integration agreements and the relevance of regional PIs thus constitute a central means to successfully promote FDI since, on the one hand, they enable more investments to take place and, on the other hand, they enhance coordination among host governments.

### *B. The Legislative importance of policy coherence*

As mentioned above, in relation to investment disputes, policy coherence refers to the degree of internal consistency of objectives, FDI policies, the instruments and interpretation of policies, in their regulatory form, across a range of issues, at different levels of government in different locations within the country. A high level of policy coherence is very important, as it will enhance the probability that the national development priorities will be accomplished (UNIDO, 2003). This coherence has to emerge at two levels. It should first appear in the government's policies but, to make sense, coherence should also materialize when these policies are translated into law.

At the policy level, coherence implies a high degree of consistency between the host government objectives and the actual policies implemented to achieve them, in parallel with a strong connection and coordination between the different parts of the government. Policy makers have always to bear in mind that attracting FDI does not constitute an end in itself but a means to boost industrial development (UNIDO, 2002). In this sense, IPAs should not confine their efforts to attract foreign investors but expand their work in close cooperation with other levels of the government in order to promote the kind of FDI that would reflect and respond to the overall national objectives. A strong policy coherence would limit the risks related to the strategic interventions carried out by host governments regarding FDI promotion, that is to say, the risk of abusing PIs and misusing the government's resources by capturing the wrong types of FDI or by attracting investments that never actually materialize. Furthermore, it is common that there are conflicts within a country between the aims of an incentives programme and the actual formulation of the programme, as well as the capacity of national institutions to administrate it. Policy coordination among different parts of government is therefore needed to reduce the negative impact of incentives.

In addition, it is crucial for effective FDI promotion that policy coherence, which should exist at the different levels of government, also appears in the legal framework. In fact, a strong and consistent judicial system is exactly what is often lacking in developing countries although it is vital for attracting foreign investors. Laws have thus to be coherent with the PIs implemented by host governments and this is precisely a difficult task because of the new context of the FDI



regime, the evolving framework for IP and the increasing complexity of the different policy dimensions, as described in the previous sections.

#### **4. Discussion on the Pros and Cons of FDI PIs**

Regarding the advantages and disadvantages of FDI host PIs, as a manifestation of the arguments that have so far been developed in this paper, one could straightforwardly start by stating that these advantages and disadvantages are not absolute but, on the contrary, are both relative and temporal. By means of liberalizing or regulating FDI, host policy tools are meant to distort the economic environment in order to promote FDI that boosts industrial development. Thus, the discussion on pros and cons of FDI PIs actually embodies the debate whether developing country host governments should opt for reform in the direction of either more policy liberalization or more policy regulation; even though recent trends suggest more pro-FDI laws than anti-FDI regulations have been passed (UNCTAD, 2000; 2004).<sup>29</sup>

It is interesting to start by examining the argument regarding infant industry, which is the initial key theory for foreign investment regulation. Shafaeddin (2000), who reviews the theory of Frederick List, argues that no country has developed its industrial base without relying to some extent on infant industry protection. “Both early industrialized and newly industrialized countries applied the same principle, although to varying degrees and in different ways” (p. 2). When British classical economists promoted the benefit of free trade, the United Kingdom was in a dominating position in the world economy and was thus able to take advantage of free trade, arguably at the expense of the then less advanced economies. However, it is worth mentioning List’s defence that protection should only be a means, and thus a temporal stage, to achieve economic freedom and international free trade and investment. This argument is still valid. In a world of different levels of industrialization, market failures do not enable free international competition to promote effective industrialization in the least developed countries. Therefore, it appears reasonable that developing countries encourage their infant industry by using the regulation of foreign investment. Nevertheless, regulation should be on a selective, rather than

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<sup>29</sup> Between 1991 and 1999 cumulatively national regulatory changes pro-FDI amounted to 974, and anti-FDI changes amounted to 61. In 2003 alone, pro-FDI legislative changes amounted to 220.

on a universal, basis and the level of protection should neither be excessive nor too low in order to maintain a balanced and beneficial relationship with foreign competition.<sup>30</sup>

However, taking a more concrete perspective, it is argued by Djankov et al., (2000) that regulation impedes FDI and thus disfavours developing countries. In fact, these countries often have very high official costs of entry and MNEs have to follow long procedures before investing (World Bank, 2005). Whereas the authors recognize that regulation is meant to achieve socially superior outcomes by countering market failures (such as monopolies and negative externalities), they argue that, in real terms, regulation is very often associated with higher corruption and unofficial economies. By using three measures which reflect policy coherence: (i) the number of procedures that MNEs have to go through; (ii) the minimum time required to complete the process; and (iii) the official costs of entry, the authors conclude that regulation benefits the regulator, not the whole society, and obstructs MNEs to invest. Therefore, extensive regulation has the opposite effect from its initial purpose since it is associated with socially inferior outcomes and thus, as a logical corollary, FDI policies should be liberalized.

According to UNCTAD (1998) and UNIDO (2003), the process of FDI liberalization involves three measures: (i) the removal of those market distortions resulting from restrictions and/or incentives applied distinctively to foreign investors, as they discriminate in the favour of or against some investors; (ii) the enhancement of several positive standards of treatment for foreign investors (national treatment, most-favoured-nation treatment, fair and equitable treatment);<sup>31</sup> and (iii) the reinforcement of market supervision in order to guarantee the proper functioning of the market (competition rules, disclosure of information, prudential supervision). However, it is worth mentioning that policies aimed at liberalizing FDI are not necessarily the best policies for creating a favourable investment climate and even less for attracting or promoting FDI. Moreover, one can note that the liberalization process should not be seen as a decline of the role of the State, since the third measure mentioned above relates to government

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<sup>30</sup> The term 'regulation' is herein and throughout used in its technical and positive economics sense and is not intended to invoke a normative economic judgment even though, ultimately, all economic action manifests normative consequences.

<sup>31</sup> These are specific measures that aim at creating a climate of perfect competition between domestic and foreign firms as they impose that no specific advantage can be given to one specific supplier and that foreign and domestic companies should be treated in the same way.

regulation.<sup>32</sup> In fact, whereas the first two measures imply FDI liberalization, their overall beneficial impact depends highly on the presence of competent and well-organized market supervision. Thus, one can argue that liberalization and regulation of FDI are not contradictory but rather complementary in order to attract and promote FDI that is beneficial for boosting industrial development.

Therefore, the debate goes beyond liberalization versus regulation of FDI policies and the advantages and disadvantages of PIs are relative to time and space. Investment promotion is a highly complex process and PIs have to be well focused according to the specific conditions of the country. IPAs must consider the growing tendency of benchmarking countries, as mentioned in the previous sections, according to various factors and the variables that MNEs use in their FDI decision-making. The task of drawing up IPAs has thus become increasingly more difficult, as they have to take into account these factors and variables for designing and implementing their PIs. Furthermore, IPAs of developing countries, after having carefully identified their neighbouring (or non-neighbouring) competitors, also have to consider what sort of FDI policies they will choose. Thus, there are no absolute pros and cons regarding PIs. Nevertheless, IPAs of developing countries should design PIs in accordance with the specific economic conditions of their country in order to achieve effective FDI promotion.

### **Concluding Remarks**

In conclusion, several “take-aways” can be extracted from this paper. First, it appears that the advantages and disadvantages of PIs for FDI are not absolute and do not deal with either good or bad policies. On the contrary, successful PIs are a matter of matching a country’s FDI policies to specific circumstances of the economy, stage of development, location, resources, regional agreements and international competition, in accordance with the priorities set by the government. A real customization of the PIs has thus to be completed by the IPAs in developing countries, bearing in mind all the factors and variables that guide the MNEs FDI decision-making and follow the overall development objectives of the country, as depicted in figures 3 and 4 above. Secondly, for an effective promotion of FDI, a country should be both cooperative

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<sup>32</sup> Note the role of the developmental state in Asia’s industrialization experience.

and competitive with its neighbouring partners. In fact, as seen earlier, regional-integration agreements constitute a powerful means to attract FDI, especially when governments cooperate with each other when drawing up coherent and coordinated policies. However, IPAs should also be aware of the PIs adopted by competitor countries in order to successfully attract MNEs to invest in their country. Finally, the role of IPAs has become increasingly more complicated, especially now that IP is moving towards a fourth generation. In fact, IPAs have to adopt a much more active and dynamic attitude towards FDI, by constantly upgrading the level of research and analysis as well as advocacy on their country's comparative advantages. Of crucial importance is that IPAs cooperate with other levels of government in order to design and implement coherent FDI policies, which should also be reflected in the legal framework. By complementing some FDI liberalization with coherent regulation and customized PIs, IPAs in developing countries should be able to capture and promote those FDI that can assist in speeding up their industrial development.



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