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Policy Implications

The policy implications of this analysis for attracting and using FDI for development have been touched on throughout the study. It is now time to draw them together clearly. Needless to say, policies must be placed in the context of technological change, new organisational forms and emerging strategies of global integration as noted above. They must also take into account the changing policy climate in developing countries: sweeping liberalisation of policies, freer trade, greater reliance on the private sector and a generally reduced role for the government in economic life. As a result, all economies will be increasingly tightly linked together and multinational enterprises will play a growing role in organising certain forms of production, trade and delivery of services.

This may be an attractive world for countries that are already involved in international production and benefiting from it. It may be a rather forbidding world for others, that are marginal to international production and technological change, and currently lack the wherewithal to participate even if they want to. The policies of the former should be geared to smoothing their path to fuller integration into the world economy and to ensuring that they extract the maximum benefit from it. Those of the latter should be geared to improving the basic supply-side factors that would allow them to start the integration process and to benefit from MNE activity.

There are certain elements of economic and FDI related policies that are applicable to all developing countries. However, there have to be differences in emphasis and strategy according to the level of economic development of the country and its existing participation in international production: these differences can be illustrated for three sets of countries according to their levels of development. The "advanced" countries would be the NIEs or near-NIEs, countries with relatively complex industrial structures, large manufactured exports and a fairly large MNE presence in advanced manufacturing and service activities. The "least developed" countries, at the other extreme, would be those with high reliance on a few primary commodities, a small and simple manufacturing base with low local linkages, little participation in manufactured trade and a low MNE presence (mainly in resource based activities). The others fall in the "middle level" in between these two.

Table 7 sets out the policy needs for all countries together and for the three groups. The entries are fairly self-evident and do not need much explanation. A great deal of emphasis is placed on the improvement of the supply-side factors that determine the competitiveness and basic economic attractiveness of the host economy, since this is what will finally decide its participation in the international production system.

As the table indicates, there are certain basic policy needs for encouraging FDI. In brief, these are:

- Stable and well-managed macroeconomy
- Disciplined and flexible labour force with wages that reflect true market conditions
- Adequate and competitive physical infrastructure
- Skill development at all levels, with emphasis on management and technology
- Low, stable and transparent effective tax rates

Table 7: **Policies for Promoting FDI by Level of Development**

Countries	Economic Policies	FDI Policies
All	Stable, well managed macroeconomy. Flexible and disciplined labour markets. Skill development and training. Lead role for private sector, with public sector reform as needed. Adequate infrastructure. Export-oriented trade strategies. Market oriented domestic industrial policies, easy entry/ exit. Efficient financial markets. Low effective tax rates.	Stable, transparent, non-discriminatory and predictable policies. Easy repatriation of profits and capital. Flexible, efficient and honest administration. Low effective tax rates with few exceptions. Expropriation only in extreme cases, with no national discrimination and fair compensation. Fair dispute settlement procedures with international arbitration.
Advanced	World-class infrastructure, especially in communications and IT. Provision of high level technical, scientific and managerial skills, with targeted investments in development of skills needed for emerging technologies. Free use of expatriate skills for particular needs. Selective tools for promoting infant industries. Exploitation of possibilities for regional integration or association. Stronger technology support system; promotion of ISO 9000 standards and contract R&D. Better incentives for indigenous R&D. Stronger basic research capabilities in technology institutes, linkages with industry. Improved local supplier base, in particular SMEs. Local financial system more linked to world capital markets. Venture capital financing for innovation.	Targeted promotion strategies to attract multinational enterprises into high technology and high skill activities, including advanced financial and other services. Selectively applied incentives for raising local content and undertaking local R&D, using foreign personnel if needed. Attraction of supplier MNEs in components and equipment. Encouragement of foreign banks and other services. Promotion of strategic alliances between local and foreign firms. Encouragement for MNE participation in local science and technology system, and in provision of advanced training to local employees. MNE participation in privatisation and BOO/BOT schemes. Encourage local firms to go transnational, and to cooperate with other MNEs in third countries.
Middle Level	Improved infrastructure, especially transport, communications, power, water and sewage. Promotion private participation in infrastructure. Labour markets more flexible and disciplined, with wages reflecting economic conditions. Improved supply of medium and high level technical, engineering and management skills. Vocational training made relevant to industrial needs, improved incentives for in-firm training. Controlled trade liberalisation, with appropriate supply side measures and strong incentives for exporting. Improved technology support for quality, design, energy and material saving. Liberalisation of technology imports. Improved financial system, start venture capital schemes. Promotion of SMEs and subcontracting. Improve and extend EPZs and industrial estates.	Liberalised FDI entry, including services and infrastructure. Targeted promotion strategy aimed at more advanced activities and most promising sources of export development, including multinationals from other developing countries. Simplify and faster FDI approval procedures, stronger support and information services to prospective investors. Encouragement of local linkages and use of local services. Attraction of foreign component supplier to invest. Incentives for technology upgrading and training, starting local design activity. Inducements to MNEs to set up local training centres and take employees overseas for training. Encouragement to leading local firms to explore investments overseas.

Least Developed	Better basic infrastructure, with private financing. Improved access to MNEs to natural resource base. Development of essential technical skills, especially at supervisory and technical levels. Improved enrolments in secondary and vocational education, engineering and management education at tertiary level. Strong and clear signal to encourage local private sector. Stronger extension services for SMEs, with basic support for quality control and testing. Liberalised trade and improved export processing facilities. Maximisation of regional trading/integration possibilities.	Liberalisation of FDI entry. Promotion campaign to build 'image' with MNEs, with clear signals on improved entry conditions and treatment. Stable policies and transparent, efficient implementation. Lower effective taxes and congenial investment climate. Expatriates to be allowed easy entry. Investors targeted in resource based activities, with encouragement for forward integration. Particular targeting of investors from other developing countries and NIEs in labour-intensive export-oriented activities.

- ❖ Lead role assigned to private sector, with clear legal and accounting framework
- ❖ Reform of public enterprises, with an emphasis on privatisation in which MNEs participate
- ❖ Outward-oriented trade policies
- ❖ Domestic industrial policies geared to promoting competition and free entry and exit
- ❖ Development of efficient financial and capital markets, linked to external markets
- ❖ Stable, transparent and predictable FDI policies, based on equal treatment
- ❖ Free access to foreign exchange for profit and capital remittance
- ❖ Honest, fast and businesslike administration of FDI policies and incentives
- ❖ Promotion to investors targeted to specific needs of country, based more on economic attractions and low general tax rates rather than large tax concessions
- ❖ Fair dispute settlement procedures

Apart from this set of policies to provide a conducive environment for investors, the specific benefits that MNEs can offer developing host countries can be maximised by the use of policies to strengthen local capabilities and induce MNEs to upgrade their activities.[113] The main considerations are spelled out in the table. The remainder of this chapter will therefore concentrate on policies to deal with the "new forms"of FDI that were discussed above. In particular, it will focus on the attraction of two sets of MNEs: SMEs from the developed countries and investors from other developing countries.

SME MNEs: Most SME investment from the developed world concentrates on other developed countries. Clearly, small firms face several handicaps in investing in developing countries: they lack information on investment opportunities and local conditions, they are particularly sensitive to political risk and macroeconomic uncertainties, they are unfamiliar with the different legal systems and regulations involved, they do not have the financial and human resources of large multinational enterprises, and they lack the market and personal contact that global exporters have. Thus, they tend to be rather passive in relation to developing countries, and tend to wait to be approached by prospective technology buyers or joint venture seekers. They often prefer to sell their technology at arm's length rather than undertake the expense and risk of investing directly. They are particularly unwilling to enter into the complicated and prolonged processes of getting investment approval in many developing countries.

Apart from the obvious need to have the right policy environment, with stable and non-discriminatory policies and good market prospects, the promotion of FDI by SMEs has to address the information gaps and risk elements that are inherent to the internationalisation of small firms. Many developing host countries are already making efforts to do this. A number of countries do not require formal approval for FDI below a certain size. Several that had requirements of minimum size of foreign investments have abolished them: Malaysia, Thailand and Indonesia are good examples. Korea has reduced the minimum size requirement over time. The reduction of clearance formalities is being achieved in many countries by the setting up of one-stop agencies for FDI promotion. Apart from handling all the formalities in one place, these agencies can provide information to investors and help them in obtaining all the necessary clearances. This benefits all investors, of course, not just the small ones, but in the nature of things it is the smaller firms that stand to gain most from the provision of information and help with clearances.

Policies used by developing countries to help SMEs in general (including local firms), such as lower tax rates and credit, infrastructure and other forms of assistance on favourable terms, can also help SME MNEs if their entry is facilitated in other ways. For instance, in Singapore firms with less than S$8 million in fixed assets, below 50 employees and 30% or more of local equity are eligible for special financial assistance; in Sri Lanka, firms with less than Rs 0.5 million in issued share (local and foreign) are exempted from corporation tax; in Malaysia, manufacturing SMEs with less than M$ 0.2 million in shareholder's funds and less than M$ 1 million in fixed assets are allowed certain fiscal benefits.[114]

When all these are taken into account, however, there still appears to be a shortage of schemes to address the specific needs of SME investors. What seems to be needed is a more pro-active strategy on the part of host countries to seek out, target and establish direct contact with SMEs in developed countries. This is not an easy task, since by definition the contacting of prospective investors will require more effort per unit of investment than with large multinational enterprises. However, use can be made of industry or trade associations (many SMEs in the developed world are extremely well organised to lobby and promote their economic interests), and even a modest start can have a snowballing effect over time. All the usual promotional tools can be used for this: advertising, mail shots, meetings, seminars, fairs and delegations. Special effort may need to be made to find suitable joint venture partners for SME investors, again possibly by bringing industry and trade associations in contact with each other. Needless to say, however, such promotion will only be effective if the host economy is basically a desirable place to invest in and if basic rules and conditions are congenial.

DCMultinationals: The attraction of developing world investors faces many of the problems just mentioned, when the firms concerned are relatively small, or have been very home-bound even if they are large. Much of intra-developing world direct investment has had two ways of overcoming the information and risk deterrents: it has followed trade, and it has drawn upon information transmitted by family or ethnic connections, other investors or the government. These have, as the data showed, proved extremely effective in dynamising DCMNEs within Asia. More recently, the rise of large, sophisticated developing world investors who are taking a more global view, and who may induce their smaller suppliers to invest overseas, has reduced some the problems involved. But this does not meet the needs of the myriad other firms that could become foreign investors. And it does not meet the needs of the host countries in the least developed category that are outside the ambit of existing trade and ethnic connections with the more advanced developing countries.

The solution would seem to lie again in an aggressive targeted promotion strategy to inform and attract specific groups of prospective investors from other developing countries. Much of the investment promotion by the least developed and middle-level countries is directed to traditional centres of investment in the OECD. It tends to ignore the NIEs and middle level countries that have large numbers of firms with the capabilities to invest and transfer technology. In addition, the 'image' of the host country is often biased and unfavourable, and FDI entry processes tend to be cumbersome and non-transparent. A great deal of effort needs to be made to improve on all these factors. Regionally co-ordinated investment promotion by small countries is one way of reaping scale and scope economies.

Capital exporting countries can also help a great deal by providing information, credit and fiscal incentives to their firms to go overseas. Many countries already do this, in an effort to promote exports and improve their international competitiveness and standing. However, the efforts could probably be improved and focused better. There is clearly scope for the investment promotion agencies of home and host countries to cooperate more closely, and so to save on information collection and dissemination costs. There is also considerable scope for the harmonisation of laws and regulations, property rights, equity sharing, and other requirements related to FDI.