PN-AAT-030
IAN 40535

AN ASSESSMENT OF INVESTMENT PROMOTION ACTIVITIES

Section 1: A FRAMEWORK FOR DESIGN AND EVALUATION

Section 2: SELECTED COUNTRY EXPERIENCE

Section 3: INVESTMENT CLIMATE REVIEW

Final Report

January 1984

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Submitted to: Bureau for Private Enterprise
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INTRODUCTION

The purpose of this report is to develop a framework within which investment promotion activities and proposals can be evaluated. Sponsored by the Bureau for Private Enterprise (PRE) within the U.S. Agency for International Development (USAID), this project is intended to assist developing countries' efforts to encourage and foster investments by private enterprises as a means to enhance their development performance and prospects. Using the framework established in this report as a guide for analysis, the SRI International project team examined the programs and experience of a select number of developing countries.

The numerous "private sector initiatives" being studied and implemented by the U.S. government are based on the view "...that a cost-effective way to achieve long-term, self-sustaining economic growth with equity is through the promotion and encouragement of private business activity in open and competitive markets."[*] To be sure, the overwhelming weight of historical evidence points to the conclusion that those developing countries which provide an attractive environment for private investment tend to outperform those which do not. All cross-country analyses of economic development performance indicate that countries with a thriving private commercial sector are more likely to achieve higher growth rates and living standards than other countries where private business activity is less robust.

In all market economies, private enterprises are responsible for contributing the vast majority of jobs needed to generate earning power, as well as the goods and services individuals need to maintain or increase standards of living. The activity of private businesses is also responsible for determining current macroeconomic conditions as well as

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[*] Agency for International Development, Congressional Presentation, Fiscal Year 1984, (main volume), p. 89.

future growth prospects. The private sector--which in this report is defined as the private <u>commercial</u> sector--accounts for most of the aggregate demand, output, and employment that represent short-term performance, and most of the saving and investment that provide for future growth.

Throughout much of the western world, a resurgence of interest has developed over the past few years on the subject of the legitimate role and potential contributions of private enterprise. Following several decades of concentrated attention on public sector activities and interventions, a perceptible shift in attitudes and emphasis can be observed toward efforts to improve business climates. This general trend is evident in both the developed and developing countries. While reverse policy swings can always be expected, it is highly likely that attempts to accelerate the rate of increase of overall levels of private investment--and the economic benefits associated with it--will continue to increase in the foreseeable future. Economic stagnation on a global basis and the rapid growth of international financial imbalances and debt have spawned a vigorous competition, particularly among developing countries, for new investments from increasingly cautious entrepreneurs and corporations.

Taken as a group, the developing countries comprise a wide spectrum of investment climates. The actual and potential opportunities for new business activities vary considerably, given differences in market size and effective demand, infrastructure, factor costs and regulatory environment. While the short term prospects have been clouded by international economic instability, it is possible to conclude that the "potential" demand for goods and services provided by private business in developing countries, in practical terms, is nearly boundless.

This report is prepared for PRE as a guide for efforts in developing countries to expand private investment--from both indigenous and foreign sources--by means of investment promotion programs. Methodologically, the SRI International project team divided its research into two interrelated tasks. First, the project team designed an analytical framework for judging existing or proposed investment promotion programs. Second, the team tested that framework, and modified it accordingly, in view of actual experience examined in five countries: Ireland, Taiwan, Jamaica, Egypt, and Costa Rica. The project team selected Ireland and Taiwan as paradigms of successful export-led growth, assisted by various investment promotion efforts. The three other countries selected offered the project team the opportunity to observe investment promotion activities at work in diverse developing country areas of considerable importance to the United States.

Section 1 of this report sets out the analytical framework, and Section 2 reports on the project team's country case study research. It should be noted that the purpose of the case study research was not to undertake exhaustive in-country investigations. Rather, the SRI project team sought to draw lessons for general application from actual country experience with investment promotion programs.

Finally, Section 3 of this study presents individual country investment climate assessments prepared by the SRI project team in preparation for its field visits. These assessments were not required as part of this project. Nevertheless, they are included with this report since the project team contends that it is critically important for a host government to have an objective understanding of its country's investment climate as a prelude to undertaking promotion activities.

This study was prepared by SRI International-Washington's International Policy Analysis (IPA) group. IPA undertakes economic and political studies for government and corporate clients. The IPA project team, which was led by IPA's Senior International Economist, John A. Mathieson, and IPA Director Paul A. Laudicina, also included Robin L. Turner, Douglas S. Cairns, and Philip E. Karp. Work on this project commenced in July, 1983, and was concluded in January, 1984.

EXECUTIVE SUMMARY

I. A Framework for Designing and Assessing Promotion Programs

Investment promotion is a set of activities which seek to encourage private entrepreneurs or businesses to invest in new or expanded ventures. In this report, the SRI International project team has focused on those efforts undertaken by or in conjunction with official government organizations. The ultimate objective of investment promotion is to bring about increases in employment, income, foreign exchange earnings or other economic benefits associated with those ventures.

In functional terms, investment promotion *per se* is neither mysterious nor necessarily complex. It simply involves the employment of various techniques to attract the interest of potential investors and sustain that interest from the point of initial investor inquiry to the time at which new ventures are implemented. Promotion can be likened to any marketing effort which aims to achieve a specified market share. The "market" in this case is not customers for a manufactured product, but rather the relatively limited pool of domestic and international capital.

The mystery and complexity sometimes associated with investment promotion result from several factors. First, investment promoters are often government officials with little experience in the private business sector, and hence have limited understanding of business attitudes and approaches. Second, promotion agencies often must operate within the context of byzantine bureaucratic and legal structures, which have the effect of complicating otherwise simple activities. Finally, promotion is more art form than science, with no fixed set of rules which assure that programs will be effective. Once these complicating factors are isolated, promotional activities can be easily understood.

Both the positive role and the effective limits of investment promotion should be taken into consideration by host country governments. Turning first to the limits, <u>the impact of all promotional activities is</u>

relatively small in relation to other factors involved in the investment decision process.

Investment decisions are reached on the basis of analyses by investors of a complex array of objective and subjective factors. One set of variables relates to the overall investment climate: the international and domestic business climates, local opportunities and operating conditions, and the nature of the incentives package offered. A second set of variables refers to considerations internal to prospective investors: overall business plans and strategies, capital and managerial resources, commitment to the project, and even random events and corporate idiosyncrasies.

Despite the breadth of these factors, one should not conclude that official promotion agencies can only play a minor role in bringing about new private business ventures. On the basis of its research on individual country experience, the SRI project team has concluded that carefully developed and properly managed promotion programs can in fact be employed effectively to improve the investment climate, stimulate investor interest, and bring to fruition new business activities.

Significant government involvement in investment-related activities can be divided into two sets of activities. The government as a whole is responsible for shaping the contours of the business climate: adopting an appropriate mix of monetary, fiscal and development policies; defining objectives and an official strategy for private investment; managing the process of investment screening and approval; and regulating ongoing business activities.

In addition to these duties, host-country governments--and often investment authorities--undertake three other separate sets of activities which are more specifically directed toward promotion: publicity, investor assistance, and the provision of investment incentives. Publicity programs consist of those efforts designed to attract initial investor interest, and include advertising, seminars and promotional missions, as well as direct contacts with potential investors. Investor assistance involves services provided to prospective investors in an effort to bring them closer to arriving at positive investment decisions. These services include project counselling, assistance in dealing with relevant government agencies, pre-feasibility studies, and cost-sharing programs for investment missions and/or individual feasibility studies. Investment incentives offered by host country governments constitute fiscal inducements such as tax holidays, exemptions from trade restrictions, subsidized plant facilities, utility rates, etc., which are extended to encourage and complete investment transactions.

In some cases the role of government agencies charged with investment promotion is limited to just that--promotion. The project team found that the more effective programs provided a role for promotion agencies in other investment-related activities, particularly in the formulation of investment policies and in the administration of approvals. Promotion agencies can act as an important bellwether of prevailing investor attitudes, and can provide advice on the efficacy of various policies and programs.

In the development of new programs or in the evaluation of existing programs, governments undertaking promotional efforts should address a number of important considerations prior to the initiation of new activities. An adequate understanding of the objectives, attitudes and policies related to private investment in the host country is necessary. Too often there is confusion on these matters, which in turn is magnified in the eyes of prospective investors. Investment promoters also need to have a clear conception of the host country's "balance sheet," that is, those assets which attract new investments as well as those liabilities which tend to deter investors. Finally, before new efforts are undertaken, strengths and weaknesses of past or current programs should be taken into consideration. An adequate initial comprehension of these factors will enhance a proposed program's chances for success by avoiding unwarranted expectations and ill-designed strategies.

Investment promotion programs vary considerably in size and cost, depending on the needs and goals of the host country. However, a certain critical mass is necessary for a program to be effective. A "core program" for a small country would consist of a central promotion office located in the host country, a small number of foreign branch offices, and promotional material in the form of information packets and brochures.

Promotion agencies can operate from within existing government ministries, or they can carry out their activities independently. To enhance their effectiveness, however, they should display certain characteristics. Promotion offices should have easy access to information relating to the business climate and investment policies, should maintain cooperative working relationships with other relevant agencies, and should be structured in such a way as to avoid unnecessary duplications of effort. It is also important for promotion agencies to be as uncomplicated as possible organizationally, and for lines of authority (both within and outside the agency) to be clearly defined.

A bare bones effort would be relegated to "reactive promotion," or merely responding to unsolicited investor inquiries. More aggressive programs include the use of promotional techniques to elicit investor interest actively. These include the production of more sophisticated promotional literature, advertising campaigns, additional field offices, active press relations, investment seminars and missions, and the preparation or financing of feasibility studies.

There is no magic formula to determine which among these techniques is the most effective, since results vary as a function of the country being promoted, the nature of the intended audience, and the quality of the activity. In fact, most successful programs use these techniques in different complementary combinations. However, a number of governing principles can be applied to any promotional activity. Promotion efforts should be applied in a targeted rather than a scattershot fashion. They should be based on clear, objective goals by which ongoing performance can be measured and strategies can be changed. The activities should also be supported by a strong follow-up system, lest investor leads generated be lost due to lack of procedures to pursue them vigorously. These and other attributes can be built into programs to increase the likelihood that scarce promotional resources will be used more efficiently.

II. Country Experiences in Investment Promotion

The experiences of the five countries examined by the SRI project team are varied in terms of strategies employed, resources expended and program performance. These case studies should be examined individually rather than critically compared, since the investment climates on which investment growth is dependent differ significantly. Nevertheless, the case study research evoked a number of general lessons.

Ireland

In the last quarter century Ireland has been transformed economically from a depressed agricultural nation to one of the most profitable and fastest growing industrial centers in the European Economic Community. The country's Industrial Development Authority (IDA) has played a central role in this transformation by successfully advancing attractive investment policies and then by utilizing sophisticated techniques to promote those policies. IDA developed out of an historical setting not replicable today--perhaps not even in Ireland. Nonetheless, IDA offers numerous examples of the value of establishing clear investment objectives and executing well-planned, thoroughly professional promotion programs at home and abroad.

Taiwan

The experience of Taiwan in investment promotion is characterized by early and continuous efforts to improve the investment climate, followed by relatively small but growing promotion programs. In the late 1950s and early 1960s, the government undertook sweeping reforms to steer business activities away from an import-substitution orientation and toward export promotion. Investment programs and incentives have been carefully targeted to direct new investment toward areas in which Taiwan has a comparative advantage. Investment promotion activities are currently carried out by two integrated agencies, the Industrial Development and Investment Center and the Joint Industrial Investment Service Center, both of which are organized within the Ministry of Economic Affairs. The latter center is relatively new, and serves as a "one-stop shop" for potential investors. Taiwan's promotional effort is being expanded in view of greater competition for investment and in order to assist the current economic strategy of expanding technology-intensive industries.

Jamaica

Concerted attempts to attract private investment are relatively new to Jamaica, and stem directly from the current government's objective of increasing the scope of private enterprise. Jamaica's laws regarding investment and incentives have been on the books for several decades, but investment stagnated during the 1970s due to general economic decline and the anti-private enterprise rhetoric and policies of the previous government. The current structure for promotion is dominated by Jamaica National Investment Promotion, Ltd. (JNIP), an independent agency which reports directly to the Prime Minister. Created in 1981, JNIP has conducted an extremely active promotion program, and statistics on new investments indicate a considerable amount of initial success. In 1983, the number and size of new investments declined, largely as a result of growing shortages of foreign exchange in Jamaica. JNIP's efforts are duplicated by a large number of other government agencies, and are made more difficult by the fact that only limited attempts have been made by the government to reduce bureaucratic inefficiencies and remove anti-business biases in regulations and procedures.

Egypt

Egyptian efforts to encourage private sector investment over the last ten years have met with disappointing results, despite substantial government attention and U.S. support. This failure is attributable more to the serious problems prospective investors encountered within the Egyptian investment climate itself than to the fragmented and inconsistent promotional efforts of the past. Recent evidence suggests that the Egyptian Government understands these problems and may be prepared to undertake some of those measures necessary to organize its investment related activities more effectively. In the past year the current leadership of the Egyptian Investment Authority has set it sights on streamlining the lethargic investment bureaucracy before initiating aggressive promotion activities. It is too early to tell whether or not the measures taken are adequate to help reverse this country's negative investment climate image.

Costa Rica

Costa Rica's traditionally stable and progressive national environment has been tested by a major economic crisis over the past few years. To help meet the country's acute need for foreign exchange, the current administration has stated its intention to promote foreign investment aggressively and has begun to initiate those policies essential to attracting new investment. However, additional significant changes in investment policy are probably essential if Costa Rica's nascent investment promotion activities are to be successful. At the same time, certain institutional reforms will be required to enable Costa Rica to compete effectively for investment within the Caribbean Basin.

III. Conclusions

No single formula can be applied to evaluate the effectiveness of existing promotion programs or proposals for new programs. The ultimate measure of performance is the number and size of new investments implemented in the host country. The role of promotional agencies in the investment decision process is indeterminant. In addition, all programs should be assessed on a case-by-case basis, since promotional efforts should be tailored closely to local conditions and government structures.

Investment promotion programs can be subjected to cost/benefit analysis, since quantifiable costs are incurred and quantifiable benefits are achieved. Costs include the operating budget of the promotion agency, marginal expenses of applied promotional techniques, and costs associated with incentives provided. Benefits include the generation and support of investor interest and the eventual economic gains derived from new investments, in the form of employment, income, foreign exchange earnings and tax revenues. However, <u>cost/benefit calculations should be made only with great care, since they assume that promotion agencies are principally responsible for new investments or the lack thereof</u>.

A less ambitious technique can be employed to assess the effectiveness of promotion programs as well as to improve performance. Based on detailed records of investor inquiries, individual presentations, site visits, investment applications and approvals, this system would keep track of investment prospects from the time of initial inquiry through actual implementation of new ventures. In this way, the relative performance of specific promotion techniques can be evaluated, and structural problems in the government's approval process can be identified.

Criteria for evaluating promotional programs and proposals relate to program clarity and measurability, flexibility, institutional capacity and feedback mechanisms. Additional criteria can be applied to examine specific components of promotional efforts--promotional literature, advertising/media campaigns, overseas office, press/public liaison, seminars and missions, and feasibility studies. Each of these criteria should be adapted to suit the individual program or proposal being assessed.

In the course of its research, the SRI project team identified a number of general principles which should underlie all investment promotion efforts:

1. Before promotional programs are developed, an honest examination of the host country's investment climate assets and liabilities should be undertaken.

2. Investment promotion agencies should be involved in the development and review of investment policy.

3. Investment promotion activities should be tailored to a host country's national character and objectives.

4. Investment promotion activities should be staffed by highly-motivated, private enterprise-oriented individuals with business experience (directly, or at least by academic training) and excellent communications skills.

5. Promotion program goals should be as specific as possible in order to increase the likelihood of effective design and execution.

6. Initially, investment promotion activities should be characterized by modest programs and expectations.

7. The promotion of indigenous investment should be a fundamental objective of investment promotion activities.

8. Promotion agencies should develop and nurture domestic constituencies in support of private sector initiatives.

9. Promotion programs should be tested, reviewed, and adjusted regularly as changes in the marketplace and the host country environment warrant.

10. Investment promotion programs should be allowed sufficient time to work.

Careful application of these largely common sense principles to a country's unique character should help substantially increase the yield of investment promotion programs.

Section One

A FRAMEWORK FOR DESIGN AND EVALUATION

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A FRAMEWORK FOR DESIGN AND EVALUATION

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I. INVESTMENT PROMOTION IN PERSPECTIVE

Investment promotion can be defined as a set of activities whose overall objective is to help bring about or expand the growth of capital commitments in the form of business ventures. Promotional activities can be divided into three categories: publicity, pre-investment assistance and investment incentives. These three sets of activities are employed in roughly sequential order as they relate to the investment decision-making process.

In terms of publicity, most developed and developing countries attempt to promote the benefits of doing business in them. Carried out through official agencies (embassies, consulates, government-sponsored promotion offices, etc.) or through the services of public relations firms, these efforts seek to attract the initial interest of potential investors, provide general information on the country's business climate, and reassure current investors of a continuation of political and economic stability.

Once potential investors have expressed interest in pursuing business ventures in greater detail, the host country might provide those firms with a range of pre-investment services, such as government-sponsored feasibility studies, subsidized investment missions, or project counselling. These services are intended to bring prospective investors closer to making positive decisions.

The final form of investment promotion activities involves investment incentives provided by the host country to private sector entrepreneurs. Host country governments can create and have at their disposal -- if they so desire -- an extensive battery of investment incentives, all of which imply some form of preferential treatment to attract and keep capital investments.

For analytical purposes, particularly in the context of the objectives of this study, it is important to create one additional distinction between the three sets of promotional activities described above. Programs related to both publicity and pre-investment assistance can be combined substantively into a category which can be called information-based promotion activities. In combination, these programs represent efforts to provide information and analysis to investors prior to the actual implementation of a new or expanded business venture. Incentive-based promotion activities, on the other hand, constitute various forms of assistance provided after the investment decision has been made, and can be defined as any policies, programs, or measures which have the effect of increasing the rate of return on investments.[1]

The distinction between information-based and incentive-based activities is important for several reasons. The former set of activities tends to assume the existing business climate of the host country as a given, and so seeks to portray prevailing conditions in as attractive a manner as possible. The latter category represents an integral component of the business climate itself, since it includes actual policies and practices affecting ongoing business operations. In addition, it is much easier to modify information-based programs or expand them on an incremental basis, since doing so would not necessarily require basic changes in government policy. Alterations in incentive programs tend to be much more fundamental, costly, and complicated. Finally, much of the academic literature on "investment promotion" in fact refers exclusively or primarily to incentives, with little or no attention given to information-based activities. This report concentrates on information-based promotion as an important component in overall efforts.

Before proceeding further with a general discussion of investment promotion, one basic caveat is in order. The impact of all promotional activities is relatively small compared to other factors involved in the investment decision process. Foremost in the minds of potential investors, both local and foreign, is whether or not the domestic business climate is conducive to new projects. The business "climate" or "environment", used interchangeably in this report, is defined as prevailing and projected market conditions and the rules and regulations associated with doing business. The most well-crafted investment promotion program conceivable will not be able to entice new business ventures if the climate is fundamentally hostile to potential investments in that, for whatever reason, eventual profit streams cannot be reasonably anticipated. However, since individuals within any economic system require goods and services to sustain life and standards of living, and since these goods and services must be supplied by some means, no country can be judged as providing absolutely no opportunities.

The basic conclusion to be drawn from this caveat is that expectations concerning the role and actual or prospective accomplishments of investment promotion programs should not be exaggerated. However, nations whose governments promote well and offer incentives often have business environments conducive to investment, and so the promotional activities and investment climate are mutually reinforcing. Finally, the impact of promotion can be relatively significant in instances where the domestic business climate is good, but not widely known.

Elements Affecting Investment Decisions

The achievement of positive investment decisions is dependent on a wide range of prerequisites which can be divided roughly among the seven following categories. Each category represents a necessary, not sufficient, set of conditions, which implies that a major shortfall in any single category may result in a negative decision on the part of the investor. The following categories are listed in increasing levels of specificity. The first group relates to the investment climate, and the second group involves factors internal to potential investors.

Investment Climate Variables

1. The international business environment (e.g., financial stability, interest rates, the trading climate, etc.) must be sufficiently conducive to warrant new investments. This holds particularly for foreign direct investment, but also for local investment dependent on international transactions.

2. As with the international side, the domestic macroeconomic and political climate must be currently or prospectively attractive as a milieu

for new business ventures. The present performance of the host country economy as well as the future outlook in terms of growth, inflation, foreign trade and balance of payments, debt, income levels, and so forth, are viewed as key indicators of opportunities to potential investors.

3. The local operating conditions associated with doing business must exceed a certain threshold of acceptability. In conducting project evaluations, private firms examine a large number of factors (raw material costs, labor skill levels and costs, rents, utility rates, regulatory requirements, etc.) in order to determine whether or not a proposed venture is feasible. Investors must also obtain a reasonable degree of confidence that the current and successive governments will hold to their commitments throughout the life of the investment.

4. The investment incentives package offered by the host country can in some instances have a material impact on investment decisions.

Internal Investor Variables

5. The proposed investment must fit coherently into the parent firm's overall business plan or strategy. To a large extent this set of conditions is determined by the investor's internal needs and management style, but it is also affected by the comparative advantages offered by the host country economy, such as market potential, raw materials availability, or low-cost skilled labor.

6. The investing firm must have sufficient means, in the form of capital and managerial resources, to undertake the venture, as well as the necessary level of commitment required to carry forward an investment project from the conceptual stage to actual implementation.

7. Finally, corporate idiosyncrasies or unanticipated events often alter investment plans. For example, key personnel involved in a proposed venture might be transferred to different corporate divisions. Similarly, smaller investors might reach decisions on the basis of their personal experiences in the host country.

None of the prerequisites listed above necessarily relates to or is affected by formal investment promotion activities. For example, the interests and capacity of the investing firm are largely but not exclusively independent of investment promotion programs. Likewise, the international climate is completely beyond the reach of any official promoting entities. The general dearth of international investment flows in recent years has been primarily a function of the high level of instability that has characterized the international financial and trading climate. Nonetheless, promoting entities can intervene in a positive way at several junctures in the decision process, and this is ultimately the objective of promotion efforts.

The Role of Investment Promotion

Subsequent sections of this report will identify the various functions of promotional programs, but it is useful at the outset to take an overview, since the comprehensive role of investment promotion, and the need to integrate components of the overall program, are often lost sight of as specific activities and proposals are evaluated.

The functions and requirements for effective investment promotion can be divided into three basic components.

1. Identify and attract potential business entities interested in investment opportunities. This was discussed previously as the "publicity" component of the program, relating to various means to advertise the general attractiveness of the host country's business climate.

The requirements for carrying out this role effectively include the development of knowledge and efficient means for transmitting that knowledge to both potential investors and the host country government. First, the promoter must have a clear idea of the investors' and the host country government's objectives, which may differ in substance, with some conflicting and some coinciding. Corporate goals, for example, include profit maximization, diversification of markets and sources of supply, maintaining or preempting a market position, and achieving some rate of overall growth in sales or earnings. Host country objectives, on the other hand, include maximizing employment or tax revenues, stimulating exports and output, developing local technological and entrepreneurial capacity, generating foreign exchange, encouraging small industries or rural development, improving the distribution of income among regions or population groups, and so forth. Even though both the host country government and potential investor may be examining the same economic activity (e.g., a new plant), they approach that activity from different perspectives, and so the investment promoter must be able to translate these goals interchangeably. In addition, the broker must have a strong knowledge of the host country--that is, the nature of the business climate, economic and political conditions and prospects, both positive and negative--since credibility is a major factor determining the promoter's effectiveness.

Once sufficient information has been obtained, the investment promoter must purvey that knowledge to both investors and the host country government. To do so, the promoter must possess the understanding and means necessary to disseminate information effectively to both corporations and government bodies.

2. After contacts have been made and initial levels of interest have been determined, the investment promoter must then employ various methods to bring the potential investor closer to making a positive decision. This "pre-investment assistance" component of the program involves formal investment missions, data-swapping sessions, informal social functions, feasibility studies, etc., all aimed at increasing the stake and interest of both the potential investor and the host country government. The requirements for this role include access to more detailed information (or knowledge of where to obtain it), sufficient financial and organizational resources to deal effectively with investors, and most importantly, adequate access to senior officials whose involvement is instrumental to the eventual approval and implementation of the investment.

3. <u>Provide inducements for and facilitate consummation of negotiations</u>. The promoting entity itself most often does not possess the means to offer incentives, but it can interact with the relevant host country agencies in the development of appropriate incentives, and it must effectively communicate the availability of and limitations on incentives provided by the host country. The investment promoter often serves as an intermediary in negotiating agreements. In addition, the promoter can stand by to offer counselling or intermediation (as an "interested party") during the period of negotiation or during subsequent times of conflict.

Even if an investment promotion program is funded and/or operated by the host country government, it should establish a two-way flow of information and it should achieve a high degree of credibility in order to carry out its role effectively. The promoting entity should also remain prepared to involve itself actively at critical points during the investment decision process, both in the active sense of sustaining levels of interest, and in the defensive sense of being prepared to deal with any problems that might arise.

II. A PRIORI CONSIDERATIONS AND CRITERIA

Investment promotion activities can themselves represent key indicators of a country's willingness and ability to attract capital investments. They often reflect the level of sophistication of the business environment and more often reflect the government's attitude and degree of commitment to private sector development.

With this in mind, if a developing country government does seek to increase private investments, it should build, develop and conduct its promotional programs within a rational, internally consistent framework. Frequently such a framework requires a great deal of a priori thought and consideration.

In the real world, those seeking to attract new investments do not have the luxury of starting from scratch, but rather must examine proposals for promotional activities (often marginal) within the context of programs already in place and extremely difficult to dismantle. The following discussion of investment promotion can hence be viewed as a means to analyze the rationale, general approach and efficacy of existing programs, as well as to study individual components within them or those proposed as additions.

The most positive first step for any agency intent on embarking on or reorganizing an investment promotion program is to undertake a set of preparatory activities and exercises, the purpose of which is to produce a clearly-defined set of objectives and a step-by-step management plan for attaining those objectives. In this way, through careful preparation, analysis, and planning, it is likely that resources will be saved and/or employed more efficiently in the actual execution of the investment agency's promotion activities. What is not advisable is for an investment agency to embark on promotional activities without having first addressed the preparatory exercises described below.

The necessity for careful planning is illustrated by the exhaustive planning and analysis undertaken by a corporation considering an investment. Corporate planning departments or their functional equivalents typically work through some variation of the following process. They take as a starting point the corporation's overall strategic objectives, which are aggregated from the firm's operating units, departments and officers, and then are assigned relative priorities. These objectives are usually based on an evaluation of the corporation's strengths and weaknesses, in terms of both balance sheet performance and operating and managerial capacity.

Once strategic objectives have been set, the planning department then weighs the various general means that can be employed to meet those goals. The next step involves the distillation of broad business plans into specific investment alternatives, which are reviewed in the context of the company's financial and organizational capabilities. At this stage the alternatives are winnowed down to a small number of good candidates, and then, only at this point, detailed feasibility studies are conducted to ascertain estimates of return on capital (ROC). Finally, if the ROC for the prospective investment exceeds the threshold that the corporation has stipulated for its business ventures in that country, and if no unforeseen problems arise, then a "go" decision can be made. Throughout this process, the project is subjected on numerous occasions to interdepartmental reviews, for two reasons: first, to elicit ideas, reactions to and criticisms of the project; and second, to establish a degree of corporate consensus and concurrence sufficient for proceeding with the investment.

Investment promotion agencies are not in fact corporate entities, and must deal with a markedly different set of goals and constraints. However, from a managerial perspective, the development of investment promotion programs would be well served by a strong dose of "corporate mentality."

In designing or evaluating investment promotion plans, the responsible agency or individuals must deal satisfactorily with the following a priori conditions and substantive areas.

- Host country objectives
- Host country attitudes toward private investment

- Existing host country "assets" and "liabilities" as they relate to attracting investment, as well as those of important competing host countries
- Prevailing business attitudes toward the local investment climate
- Existing promotional efforts

The areas to be evaluated are discussed in further detail below. The optimal approach would be to carry out an evaluation or "audit" of each of these issue areas, which are then combined into a single "white paper." In order to assure that the evaluations closely reflect the perspective of the host country government, the evaluations should be conducted by or in close collaboration with responsible officials. It is the responsibility of the host country government to determine its own economic strategy and framework for the conduct of private enterprise.

The aggregate a priori evaluation would be carried out with the primary intention of serving as an initial planning document for official agencies considering changes in investment promotion plans. As such, it should include an honest assessment of the areas covered, including problems and constraints as well as positive factors. The document could therefore provide an important guide for efforts by the host country government to deal constructively with weaknesses in the system as well as to devise means to utilize and expand strengths. The importance of assessing weaknesses in the system at the outset is underscored by the fact that, in terms of attracting additional private investment, the ultimate payout of steps to improve the policy framework or business climate far exceeds that of even major promotional activities.

A second use for the aggregate evaluation would be the creation of substantive material for the promotion process itself. Much of the factual information generated could be edited for inclusion in promotional literature, without a great deal of additional research. Access to the "unvarnished" version of the "white paper" would be considered extremely valuable to prospective investors. However, if it is in fact a candid appraisal, it would surely include sensitive material, particularly that which is critical of current practices. Distribution of the initial evaluation would have to be weighed carefully. On the one hand, its dissemination could give rise to undesirable political fallout. On the other hand, it could serve to enhance the credibility of the host country and/or promoting agency.

Some might draw the conclusion that the "audits" required would involve lengthy and costly efforts, but in most instances this would not be the case. Much of the substantive areas to be analyzed have already been examined and presented in such documents as development plans, budget presentations, economic forecasts, and legal briefs dealing with investment issues. Therefore, the bulk of the exercise would involve gathering and synthesizing existing information, and presenting it in a unified document, rather than generating new data.

Whether or not any formal evaluation is undertaken, the following issues should be examined in some fashion. If they are not, the likelihood that scarce promotional "resources" will ultimately be misspent rises considerably.

Host Country Objectives

The evaluation of host country objectives should proceed through at least four levels of analysis: macroeconomic and "socio-political" goals, microeconomic objectives, priorities, and objectives directly related to the role of private investment.

The macroeconomic goals of most host countries are relatively straightforward, at least when applied to the long run. Domestic objectives include increasing GNP growth rates, raising levels of income, reducing unemployment, expanding government revenues, and achieving a desired degree of price stability. Additions to this standard set of goals might include improving the internal distribution of income, raising nutritional standards, or accelerating the use of appropriate forms of technology in economic activities.

With regard to a host country's international economic performance, important objectives include the generation of additional foreign exchange earnings (via exports of goods and services), improving the balance of payments, containing external debt to manageable levels, and achieving a reasonably stable foreign exchange rate.

Statements related to macroeconomic goals are often accompanied by explicit or implicit pronouncements on general social or political objectives. These generally focus on desires to improve standards of living, reduce infant mortality, increase levels of literacy, and other factors affecting the population's social well-being, and items such as protecting national sovereignty, developing natural resources, enhancing defense capabilities, maintaining domestic tranquility, and protecting the nation's cultural identity.

Working into a greater degree of detail, a host country's micro-economic objectives focus on the array of targets related to economic sectors, industries, or factors of production. Often these goals are spelled out in development plans, which allot special attention to sectors such as agriculture, light manufacturing, heavy industry, or services. Economic planners might also concentrate on the desire or need to develop particular forms of infrastructure (transportation, communications, health and sanitation services, etc.), or particular forms of production (labor-intensive, technology-intensive, raw material-utilizing, etc.). In addition to sectoral goals, individual geographic regions within host countries are often targeted for accelerated development. These regions are either depressed or economically stagnant areas, or areas such as free trade or export processing zones which are slated to act as centers of growth for the economy as a whole.

The relatively facile exercise of establishing overall economic objectives must be followed by the much more difficult task of determining relative priorities among them. Extensive "wish lists" of goals remain meaningless until hard choices are made on tradeoffs. The most obvious tradeoff is between strategies oriented toward rapid growth and those which place a higher premium on price stability. Until recently, most developing countries have taken the former course, but the resulting buildup of external debt has forced most to effect drastic policy reversals. Similarly, microeconomic targets must be ranked according to some order of priority, particularly if policy instruments such as subsidies, incentives or other forms of budget outlays are involved. All of these decisions require difficult economic and political choices.

The final set of objectives is of direct and critical interest to potential investors, since it focuses on the <u>desired role of private investment</u>. Unlike the goals summarized above, these objectives are less likely to be spelled out in some formal document. However, they constitute the most important component of the "self-evaluation" proposed, since they would define the country's basic approach toward indigenous and foreign investment, and act as a standard by which actual policies and programs could be judged.

For any country earnestly seeking to accelerate the development of the private sector, the fundamental goal is to provide an environment in which private enterprise can contribute to national goals while minimizing the costs and maximizing the benefits of private investment.[2] There is an extensive literature on the benefits and costs of private investment, and discussions of the pros and cons will continue to receive attention. However, the widespread antagonism to private foreign investment prevalent in the early 1970s has subsided. Both private firms and the governments of developing countries have learned from their experiences, and bargaining for investment terms in many cases takes place on a more equal footing. This process will continue, since host countries seek additional capital inflows, on terms they can accept, and since firms seek to establish a long-term presence with adequate returns.[3] The basic lesson that has been learned over the course of the past decade is that it is within the power of the host country government to determine and maintain the legal and policy environment within which private enterprises--local and foreign--conduct their business, and that this environment can be made highly attractive to private sector development.

Host countries can turn to private investment to provide the means for reaching a wide range of development objectives:[4]

- Generate income, foreign exchange, tax revenues, and other aggregates at the macroeconomic level.
- Increase employment and manpower skills in both the modern and traditional sectors.
- Alter the regional distribution of income.
- Change undesired sociocultural institutions and values.
- Provide economies of scale for infrastructural development.
- Increase levels of competition, industrial efficiency, technological development and product innovation.
- Provide access to international markets for domestically-produced goods and services.

At the same time, private investment can be faulted for causing or contributing to such undesireable developments as excessive urbanization, environmental despoilation, the introduction of inappropriate technologies and products, and so forth. The host country government must therefore take stock of its own priorities and establish a system of rules to cover the conduct of private business.

The establishment of national goals is important in its own right, but it is a particularly important first step in efforts to attract investment. Most corporations are capable and willing to operate within a wide range of policy environments, but they are especially attracted to areas where policy goals are clearly defined and adhered to over time. One of the principal conclusions of a survey of ninety major international firms was that corporations would like host country governments to express national objectives clearly in a framework of laws and regulations that the firms could then take into account before deciding whether or not to invest. If the national goals were stated in this fashion, then the companies could accommodate to them.[5]

Host Country Attitudes and Policies Toward Private Investment

No government or promoting agency should enter into the business of attracting new investment until it has established a clear idea of the basic attitude and policy stance held by the government and the general public toward private investment. A concerted effort to arrive at a consensus view would in all likelihood act as a powerful force in assisting promotional objectives and attracting the active interest of the business community.

The treatment of foreign versus domestic investment is an important factor to be addressed. Indigenous and foreign investment do differ in their sources of capital, management styles, and corporate control. Furthermore, indigenous investors may or may not enjoy more support among national policymakers than do foreign investors. Nonetheless, the overwhelming consensus among business executives and policy analysts is that, from the standpoint of economic and bureaucratic efficiency, local and foreign firms should be subject to a common set of rules and opportunities.

Consensus notwithstanding, many host countries treat indigenous investment and foreign investment separately, in spirit and in law. Some countries offer unique benefits to foreign investors, whereas others subject foreign firms to rules and regulations beyond those required of local firms. All countries reserve certain economic activities, such as utilities, transportation systems, and communications services, for domestic firms. This practice is legitimate and is accepted as an international norm. In order to protect "nat onal" interests, however, some countries have gone to the extreme point of restricting foreign investment even in sectors in which local investors are not interested or do not have the technical capacity to operate. Host country governments must carefully weigh these interests and arrive at an appropriately balanced approach.

An important issue requiring resolution is policies and practices regarding local equity ownership. Multinational corporations have historically resisted joint venture or local majority ownership requirements but have become much more flexible over the past decade. What is critically important to foreign investors is that ownership provisions, like all rules and laws, should be clearly stated and should not change radically over time. Therefore, such provisions should be developed and maintained within the context of the host country's long term objectives.

In its case study research, the project team found a general tendency for investment authorities to be biased in favor of foreign rather than domestic investors, at least in terms of promotional efforts and investor assistance provided. In some cases this was due to the fact that foreign and domestic investment issues were managed by separate agencies. Several investment authorities acknowledged this bias and have undertaken corrective steps, but in general domestic investment potential has been neglected. Therefore, <u>a principal conclusion of this report is that much greater effort should be expended in promoting and assisting indigenous investment.</u>

The exercise of elucidating the host country's attitudes and policy stance toward private investment can prove instrumental in attacking two substantial hindrances to new investment--inconsistencies among different government agencies, and inconsistencies among investment policies. A typical complaint voiced by private investors is that after a lengthy effort to obtain the necessary clearances from "X" and "Y" ministries, their project is then halted by a recalcitrant Ministry "Z". Even beyond the standard problems of bureaucratic inefficiencies and red tape, fundamental differences in attitude and approach often emerge between agencies and ministries. This is particularly true, for example, between a Ministry of International Trade and Industry, which tends to favor private investment, and a Ministry of Public Enterprises, which tends to oppose private investment in its area, since the venture poses a perceived threat of actual or potential competition. The host country government therefore has to deal with these understandable conflicts by promulgating a uniform investment "code" which is adopted by the highest level of government, most likely the cabinet.

Policies governing the conduct of private sector operations often contain internal inconsistencies, some of which can be considered nuisances, but others of which are fundamental. Perhaps the most ominous development in the international investment environment is the growing frequency with which individual firms are offered grants or subsidies on the one hand, and are subjected to performance requirements on the other. These contradictory policies not only introduce gross inefficiencies but also complicate business management, sometimes to the point of rendering it impossible.

A recent example involving an international dairy company's investment in a major developing country is instructive. In order to conserve foreign exchange, the host country granted the company a license to produce milk locally rather than import milk. The company built its plant, arranged its milk supply market, but then failed to obtain import licenses for the relatively inexpensive paper and wax containers necessary to distribute the milk. Since the cartons were not produced locally, the dairy company was forced to discontinue its operations at a substantial loss. Stories of this nature circulate rapidly among the local and foreign business communities and often dissuade potential new investors.

Crafting and maintaining a consistent, coherent investment policy is the single most effective action a host country can take to promote investment. Corporate entrepreneurs are fully prepared to assume the "business risks" associated with the vagaries of the market and swings in economic activity, and even shifts in macroeconomic policies, but they react strongly to unanticipated changes in the "rules of the game." Therefore, potentially wasted resources spent on promotional activities could be saved if the host country government first undertakes to develop a clearly defined investment policy, based on fundamental principles and objectives broadly supported by the government and general public. In some cases, public attitudes toward investment constrain government options. However, governments can play an effective role in efforts to change popular misconceptions.

Host Country "Balance Sheet"

Another preliminary step to be taken in the development of an investment promotion strategy is an assessment or "audit" of the host country's fundamental "assets" and "liabilities" as they relate to attracting private investment. This evaluation should provide answers to two questions:

- Strengths - why should a private firm invest in this country?
- Weaknesses - what factors, individually or in combination, would tend to deter private firms from investing in this country?

The simple objective of this exercise is to obtain an honest appraisal of the operating conditions and opportunities available to private investors.

This evaluation need not be an extensive inventory of facts and figures, but rather should represent a schematic profile of the basic strengths and weaknesses of the business climate. It would constitute an effort on the part of the host country investment authorities to examine the local climate from the viewpoint of the private entrepreneur, the ultimate audience of the promotional program.

The literature on the subject of determinants of private investment is extensive. Most survey data show that investors place high and relatively equal weights on market factors and cost factors, a high but somewhat lower weight on the general investment climate, and a low weight on barriers to trade.[6] Foremost among market factors are the size and growth of the market, which are of particular interest to firms interested in producing goods and services for local consumption. Cost factors include the availability and wage scales of labor at appropriate skill levels, the availability and price of raw materials, land and utility costs, and so forth. These cost factors are of interest to all potential investors, but especially those examining alternative production sites for exports. Investment climate variables include general attitudes toward investment, political and economic stability, the tax and foreign exchange structure, barriers to trade, and the regulatory environment.

Investment promoters should have a clear picture of the nature and quality of the "product" they are selling, for several reasons. First, to be effective with prospective clients they must have credibility, which in turn requires a strong ability to respond honestly and knowledgeably to hard questions concerning the investment climate. Second, given the rising degree of competition for scarce investment funds, promoters must be able to compare their "product" with those of competitors, that is, other host countries. The capacity of the promoters to sell their country effectively depends directly on their knowledge of actual business conditions.

Business Community Attitudes

While it is useful and in fact recommended that official government bodies carry out their own evaluations of the domestic business climate, it is likely that a certain degree of bias will be introduced into such studies. The natural tendency is for official agencies to paint an overly rosy picture rather than be self-critical. Therefore, a relatively costless and effective cross-check can be devised in the form of a companion evaluation or report prepared by the local business community.

Private business executives are often the strongest advocates of the investment climate, and this asset is often underutilized. While these executives might express criticisms of the host country government's policies, they tend to reflect in their opinions their major stake in the economy. Trade associations, chambers of commerce and other business groups are normally more than willing to extend their advice.

As a component of the preparation of an investment promotion program, the local investment community could be asked to prepare its own assessment of the business climate. This report could then be placed beside the government's assessment to arrive at conclusions as to where the two agree or disagree. The dialogue alone generated from such an exercise could prove valuable. If the business community is unable to undertake its own assessment, then as an intermediate step it could be asked to read and provide formal comments on all or portions of the official report. In this way, potential "recruits" from the private sector could be enlisted for current and future promotional activities.

Existing Promotional Activities

The final *a priori* evaluation to be undertaken would be an examination of existing investment promotion structures and programs. The first step in this task involves an "inventory" audit of the personnel and resources devoted to promotional activities, the development of an organizational chart to describe lines of authority and responsibility, and an enumeration of the different methods employed in the recent past.

The second step is more difficult, since it would entail some form of normative assessment of the effectiveness of the promotional strategy and program. The only ultimate measures of "success" in this area are the number, size, and contributions of private sector investments made in the host country over a given period of time. Determining on an *ex post* basis the relative importance of promotional activities is difficult since, as noted at the outset of this report, final corporate decisions on investments are the culmination of a wide range of considerations, most of which are beyond the control of the promotion agency.

As will be recommended later in this report, a mechanism for evaluating current promotion programs can be built into the investment process at almost no cost. However, any attempts to generate data on the efficacy and utility of past efforts would be expensive and of questionable validity. Therefore, this initial evaluation of historical promotion activities must of necessity be highly judgmental.

Those individuals or organizations actively interested in promoting investment might naturally respond skeptically to a recommendation for a "pre-promotion" investment white paper or evaluation. The typical tendency is to favor "action programs" which promise immediate results, rather than "background" studies.

The purpose of the approach recommended in this report is not to delay the implementation of programs and projects, but instead to increase their efficacy. The evaluations proposed need not be lengthy treatises, and in fact, major portions of them are likely to be already available in some form. When combined into a unified report, the conclusions drawn from these assessments could serve as a strategic blueprint which: provides documentary evidence of current objectives and attitudes; notes the basic strengths and weaknesses of the investment "system"; defines measures to overcome policy inconsistencies, bureaucratic inefficiencies and overlaps, and promotional deficiencies; and secures a high level of participation and cooperation among relevant agencies.

Once such a blueprint, even if incomplete, is in hand, the remaining process of devising a promotional set of activities should flow naturally from the informational material and observations already obtained. Hence the documentation would not lie fallow but rather would be used as concrete inputs to the development or revision of a promotion strategy, thereby avoiding future duplications of effort.

III. ELEMENTS OF AN INVESTMENT PROMOTION STRATEGY

Once the decision has been made to create or modify an investment promotion program, then the responsible government authorities can proceed through a series of strategic decision points leading consecutively toward program implementation. If the groundwork described above has been laid, then the chances for this process to be completed effectively are greatly enhanced.

Functional Activities

The design of an investment promotion strategy must first take into consideration the various forms of government-business interaction, particularly as they relate to investment decisions. In this way, the structure of promotional programs can be crafted to incorporate the sequential forms of contact between potential investors and host country authorities. The functional activities to be carried out by or in coordination with investment agencies fall into the following categories.

1. Adoption of economic policies and legal investment provisions. These responsibilities lie with the host country executive and legislative branches, rather than any investment authority. However, the latter should have a voice in the formulation of economic policies and particularly in the enactment of investment statutes, since investment authorities should provide valuable feedback from the business community.

2. Research and development of promotional material. Perhaps the most important initial component of investment promotion, at least in efforts to secure investor confidence, is the development and dissemination of information which provides an accurate and up-to-date picture of business conditions in the host country. Above all, promotional material should honestly portray the host country's performance and prospects in order to establish credibility. Most investors are sufficiently sophisticated to realize that promoters emphasize positive rather than negative factors, but investors tend to lose confidence in the promoter

quickly if basic information is misrepresented or if major problems are ignored in promotional material.

3. Direct public relations effort. This is one of the most crucial functions of the promotion agency, since it involves activities to attract initial investor interest in the host country. In this regard, the promotion agency can conduct its activities through direct contacts with the business community, or it can carry out an advertising campaign via the media. In addition, the agency can hire advertising agencies and/or public relations firms to provide assistance and guidance.

4. Investor assistance and advisory services. Once potential investors have expressed an interest in pursuing a given venture in more detail, the promotion agency can make itself available to provide assistance. Generally the advisory service would include foreign and domestic branches. The foreign branch may or may not rely on the host country's embassies, consulates, or trade promotion centers. Investment counsellors would typically provide a contact point with the domestic advisory service, which would then assist the investor's in-country efforts. Investor assistance programs might also enlist the aid of international or local banks, law firms, or consulting organizations.

5. Investment screening and approval. Before any new venture can go into operation, the investing firm must obtain all the clearances, approvals and licenses necessary to register or incorporate locally. In most countries, this process can make or break new investments and often requires the involvement of myriad ministries and agencies, such as the Ministries of Industry (basic approval), Interior (land acquisition), Finance or Central Bank (foreign exchange clearances), and other authorities such as Customs Bureaus, provincial, state or local governments, and others. This process can be highly centralized, coordinated and efficient, or it can be decentralized, haphazard and extremely time-consuming.

Organizational Structure

It is probably safe to assume as a working hypothesis that virtually all investment promotion organizations are unique to their host country, at least in certain respects. Variations of organizational structures are functions of differences in governmental systems, priorities placed on investment, ministerial orientations, and even the power and preferences of individuals in high-level positions.

The organizational structure for investment promotion should be tailored to reflect as closely as possible the nature and character of the host country it serves. Therefore, there is no single, "preferred" model. Since each host country faces a different set of constraints and opportunities, organizational structures and operational emphases should be oriented to take these differences into full account.

Accepting the caveat that each situation should be approached on a case-by-case basis, a certain number of common organizational characteristics are desirable. First, the units charged with carrying out the various functional activities described above should be integrated organizationally as closely as possible. The sequential processes of investment promotion require a strong degree of cooperation and coordination, particularly for information retrieval and inter-agency referrals.

Second, the organizational structure--like the activities carried out within it--should aim to be uncomplicated and clearcut. This is true for any government agency, but particularly so for one interacting with the business community. Business executives put a high premium on clarity and transparency in their dealings with governments and they are often unwilling, or, especially in the case of smaller firms, unable to devote large amounts of resources to work their way through complicated bureaucratic mazes.

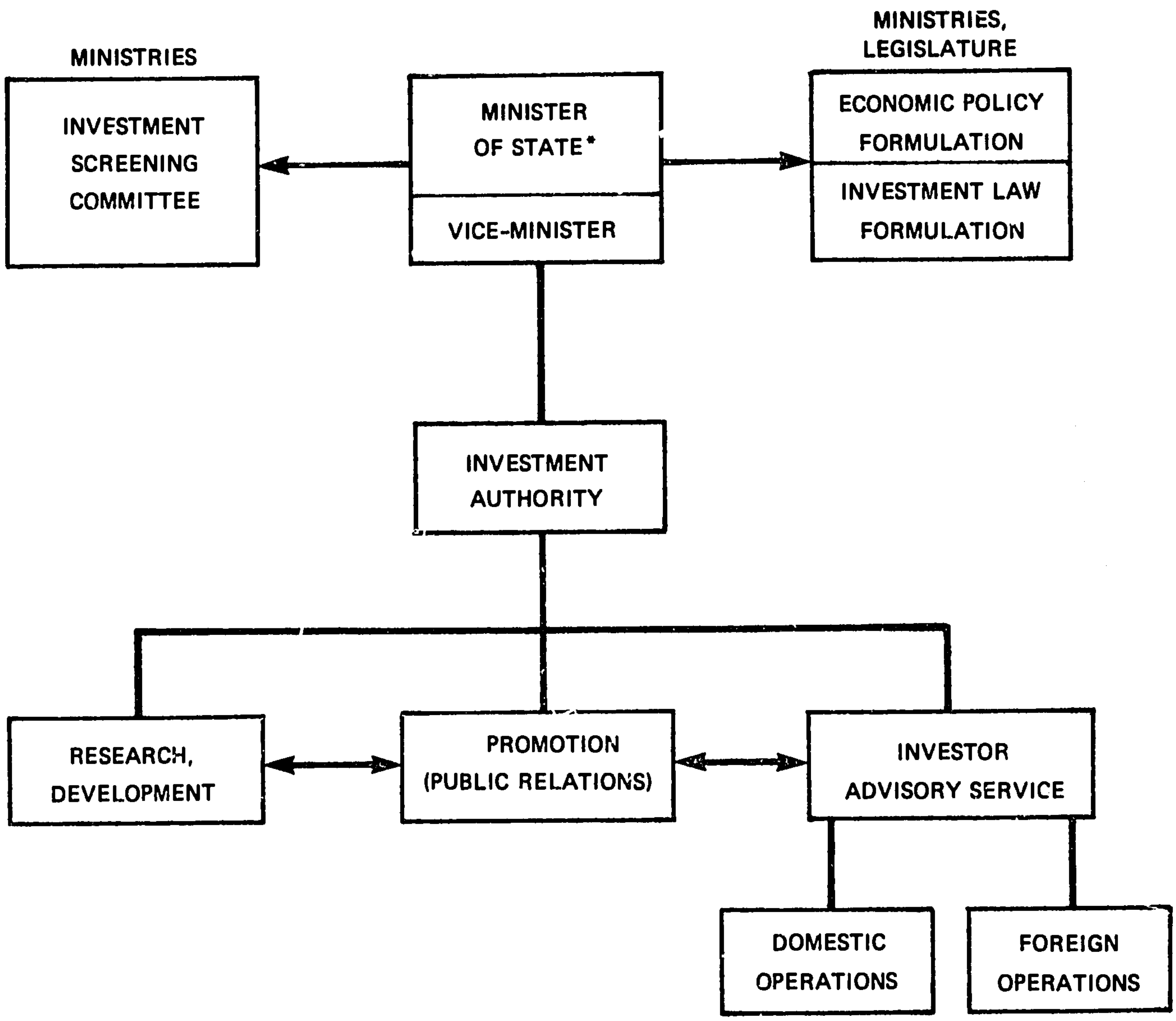
Third, the general management and operations of the promotion organization should be overseen by an individual at a high level of government. Too often investment promotion units are not extended sufficient authority to carry out their mandated tasks. In many cases, the planning process for a given new venture nears completion, only to be stalled by bureaucratic inertia or last minute reversals by other government bodies. Direct interventions by high-level officials are often required to break through these delays, but it is preferable for the investment agency to be granted sufficient authority at the outset in order to prevent such delays and reversals from arising.

The functional activities described above can be structured within any number of organizational frameworks. Some analysts would suggest that investment promotion organizations should be separated totally from the government apparatus, in order to enhance the organization's objectivity and credibility.[7] However, in practical terms such a separation is not recommended for two basic reasons. First, it is difficult to conceive of a means by which a promotional operation with a sufficient "critical mass" could be sustained financially through private sector donations or some form of self-finance such as fees. Therefore, government financing would be required. Second, in order to carry out its tasks effectively, the promotional agency would have to interact continuously with government authorities, in some cases at high levels, and historical experience suggests that this would not be possible for a completely independent organization.

With considerable variations taken as a given, investment promotion structures tend to follow one of several models. Prominent among these are models which can be described as <u>ministry coordinated</u>, <u>independent authority</u>, <u>inter-ministerial committee</u>, and <u>uncoordinated</u>. The first three of these models are shown schematically on the following pages.

In the <u>ministry coordinated model</u>, the responsibility for conducting investment-related activities falls on a single line ministry. This ministry has jurisdiction over "promotional" programs other than investment incentives, for which responsibility is shared with other ministries and

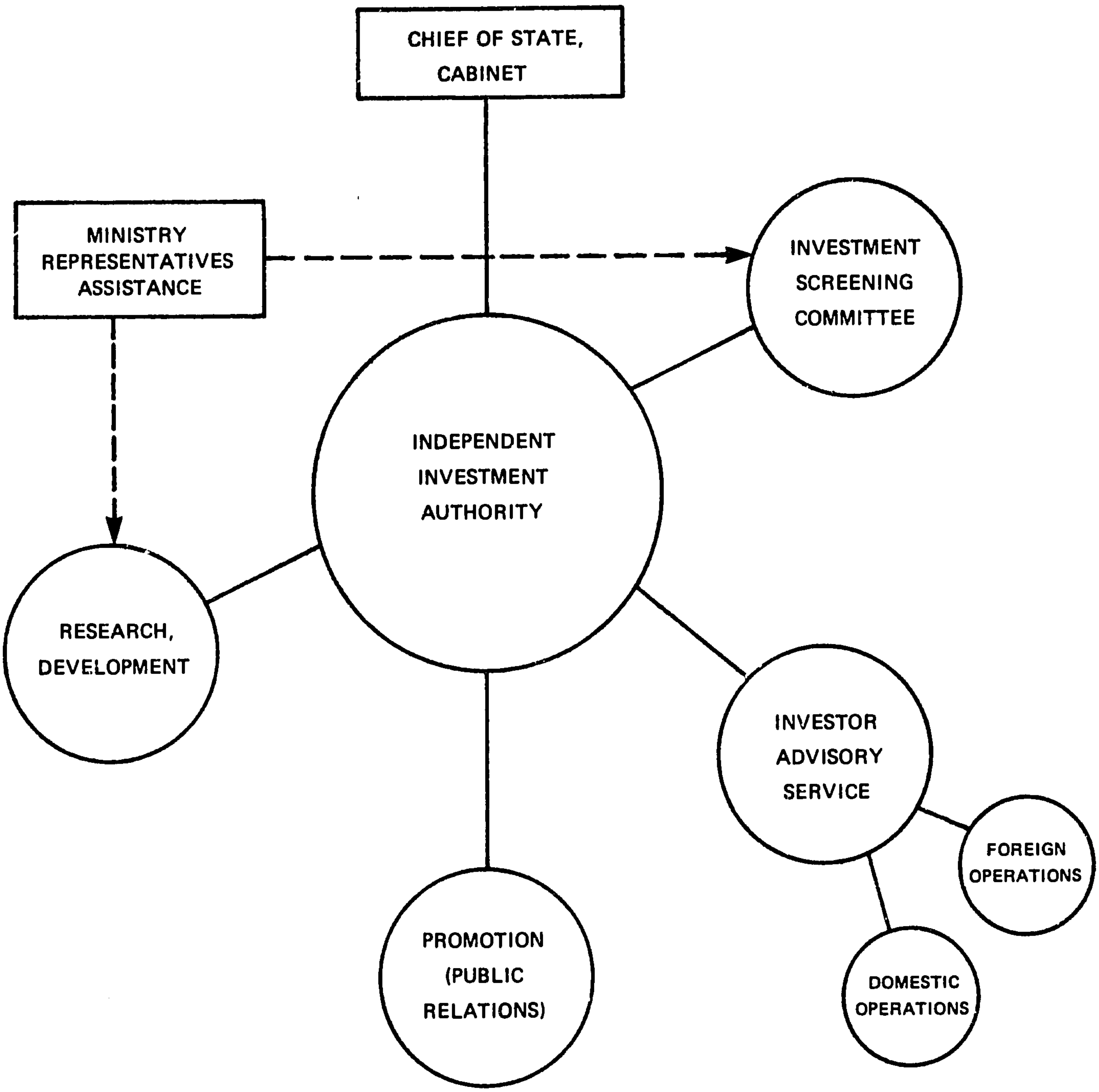
MODEL INVESTMENT PROMOTION STRUCTURES



MODEL 1 MINISTRY COORDINATED MODEL

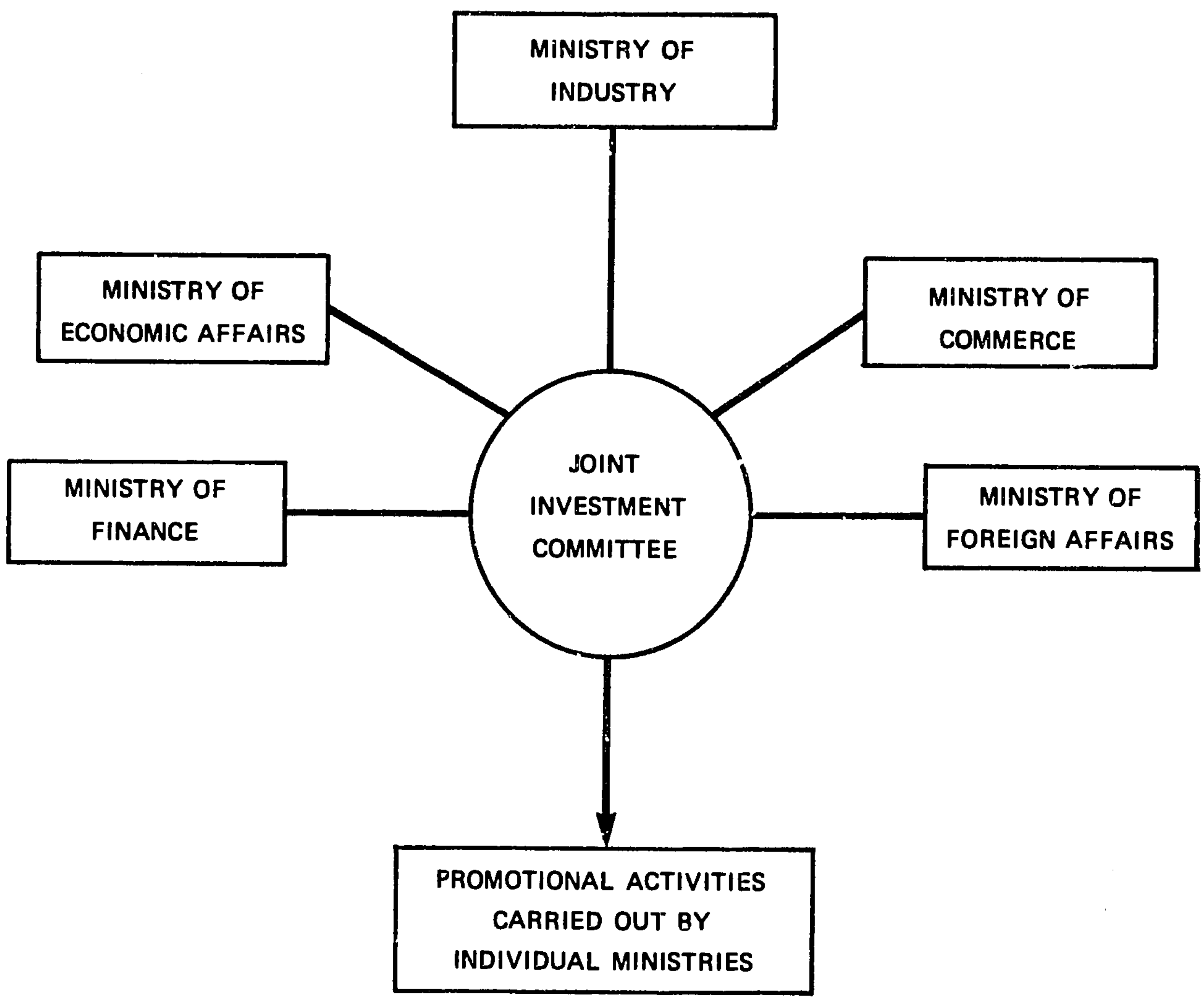
* E.G., MINISTER OF ECONOMIC AFFAIRS, INDUSTRY, COMMERCE, ETC.

MODEL INVESTMENT PROMOTION STRUCTURES



MODEL 2 INDEPENDENT AUTHORITY MODEL

MODEL INVESTMENT PROMOTION STRUCTURES



MODEL 3 INTER-MINISTERIAL COMMITTEE MODEL

the legislature. The coordinating ministry also presides over the investment screening committee, which contains representatives from other ministries and agencies.

The second model assumes the creation of an independent investment authority which is not organizationally connected to any line ministry and whose sole purpose is to manage investment-related activities. Its interaction with other government bodies is limited to the research and development of promotional material and guidance on and/or approval of investment applications. The director of the investment authority reports directly to the chief of state or to the cabinet.

The inter-ministerial committee model is less tightly structured. Representatives from the relevant ministries involved in investment issues form a joint committee which oversees promotional programs, which may be conducted through joint efforts (e.g., branch offices funded by ministries of industry and foreign affairs) or by individual ministries with approval by members of the committee.

The final, uncoordinated model, although defying simple description, is found most often in actual practice. In this case, promotional activities are carried out concurrently by several ministries or agencies, each of which vies for the same "market." Often ministries of trade or commerce provide embassies and consulates with a certain amount of promotional material to advertise trade as well as investment opportunities, or even tourism. Promotion programs and offices might be funded in part by government units and in part by private sector associations. The course of action recommended for potential investors might vary, depending on which person or organization was the initial point of contact.

Host countries need not force their promotional activities to fit into any particular organizational structure, including those sketched out above. The first two models do, however, increase the likelihood of meeting the criteria necessary for developing a successful operation. Investment promotion is in many respects an "entrepreneurial" exercise, which is closer to an art than a science. The skillful design of an efficient organizational structure will greatly enhance the prospects for a promotional effort to be effective.

Information Requirements

Organizers of investment promotion programs should never lose sight of the fact that their overall efforts, with the exception of incentive packages, must remain securely anchored in the collection, analysis and dissemination of information on the business climate of the host country. The task of promotion is to provide the business community with complete, accurate and up-to-date information on that climate. Business executives often use the quantity and quality of information provided to them as a measure of the host country's willingness and ability to attract new ventures.

The breadth and depth of knowledge which help determine the relative effectiveness of any program can be applied to categories of information: basic data on the business environment, specific information of interest to investors, and knowledge of the attitudes and goals of private investors. The "basics" include clear statements on the political framework and social fabric of the host country, data on domestic economic conditions and performance (GNP growth, inflation, levels of unemployment, interest rates, money supply growth, etc.), the host-country's international trade and financial performance (balance of payments, external debt, exchange rate stability, etc.), and the general investment regulatory environment (the role of the public and private sectors, respectively, government objectives, and the basic rules for investors). Additional information on local lifestyles, climatic conditions, infrastructure capabilities, etc., is also important. Taken together, this information provides investors with an initial overview of the society and economy.

The second category of knowledge reaches toward a higher degree of complexity and sophistication, focusing more directly on the specific factors or operating conditions examined by corporations in feasibility studies or project evaluations. This information relates to demand-side determinants (market size for a given product or process, local competition, distribution systems, etc.), supply-side determinants (land availability and cost, labor skills and costs, utility rates, transportation factors, etc.) and other factors associated with doing business, such as financial services, communications, security of supplies, etc. Important at this stage is up-to-date knowledge on the process of establishing new enterprises and on current investment incentives and performance requirements.

The final category of knowledge, which in a sense elevates promotional programs from the mechanistic to the truly art-form level, involves an understanding of the motivations and perspectives of private sector executives, both generally and specifically. The promotional "sales pitch" of published material should be crafted in such a way as to pique the imagination of the target audience and draw that audience in for a closer view of opportunities. When individual investors are identified, each must quickly be evaluated according to level of interest and capability. Then customized approaches would be developed for each serious candidate. In other words, information relating to the individual investors should be obtained quickly and skillfully so that promotional strategies can be tailored to meet their specific needs and concerns.

Creating and maintaining some form of "data bank" on the three categories of knowledge described above obviously involve increasing degrees of difficulty. Basic data and analysis should be readily available in government bodies responsible for statistical collection and evaluation. However, this information is often dated or unavailable at the user end, that is, with those units which distribute information packets in response to inquiries. Specific project-related data is seldom produced for public distribution given the costs involved; however, the promoting agency could collect some of this information routinely from other government bodies and could maintain a bibliography or a reference system for accessing data sources. Finally, knowledge of actual or potential investors must be developed on a case-by-case basis, by means of personal contacts with the investors or general reference materials (e.g., annual reports, 10K reports, Dun and Bradstreet or Moody's Reports, etc.).

Targeting

There is an almost universal consensus on the point that investment promotion activities should be targeted, both in order to direct investment flows into "priority" sectors and to utilize scarce promotional resources efficiently. From the host country perspective, targets can relate to regions, economic sectors or individual industries. Most countries, especially those which are more industrialized, tend to provide incentives for investments in economically depressed regions. In developing countries this practice is less prevalent, but emphasis might be placed on areas designated as growth centers, such as industrial parks, free trade zones, or export processing zones.

Sectoral targets generally emerge out of development plans, and concentrate on lagging sectors or those with considerable growth potential. Some countries might emphasize agriculture or natural resources, whereas others might target light or heavy manufacturing. Targets can be refined further to specific industries, such as textiles, electronics, steel fabrication, or food processing. Alternatively, targets can focus on forms of production, such as labor-intensive or technology-intensive, or concentrate on industries which create specific economic effects, like import substitution, export promotion, infrastructural development, etc. Through direct and indirect means, private sector investment can be channelled toward particular lines of endeavor, depending on whether or not the investment climate is sufficiently attractive.

Sectoral or industry targeting is considered a legitimate practice by international standards, especially for countries with particular problems such as large pools of unemployed labor, or goals such as attracting "clean" rather than polluting industries. While host countries can focus attention on "priority" sectors, they should keep the list of "unwanted" investment areas as short as possible. History has shown that governments have a poor record in choosing "winners" and "losers" among industries. However, if sectoral targets are chosen on the grounds of basic economic facts--factor endowments in terms of land, labor, capital and technology availability--governments can more successfully utilize their countries' comparative advantages. Strategies of this kind have been effectively implemented in the "newly industrializing countries" of East Asia.

Targeting is also important for those involved with investment promotion. "Scatter-shot" public relations efforts are not only time consuming and costly, but also relatively ineffective. Promotional efforts should be directed at those industries or firms which would have a natural interest in the host country. For example, small countries with limited domestic markets might not attract import substitution industries, but might serve as export platforms for manufacturers.

In addition, investment promotion activities should be assigned objective goals for achievement, to the extent possible. Such objective measures of success must be tailored to the character of individual countries as sufficient investment promotion experience is gained. These targets will also necessarily have to be adjusted frequently, based on changes in the domestic investment climate, the international economic situation and changes in the effectiveness of the promotion programs themselves. Such goals set might include the number of investor contacts made, visits to the host country by prospective investors, investment applications filed, etc. Over time, investment promotion agencies will be able to forecast the number of investor contacts needed to yield the desired number of requests for formal presentations on the country's investment climate, leading ultimately to investment applications and approvals.

While investment promotion programs are more art than science (as ultimately are all public relations/advocacy efforts), setting objective targets or goals will help establish standards for measuring the adequacy of the promotion effort and the relative costs and benefits of various promotion programs. In addition, such standards could help insulate the promotion activity from unjustified political attacks by demonstrating the objective yield of resources allocated to investment promotion. Such standards will also help justify budget increases for promotion activities as more ambitious goals are set for achievement.

Those experienced in investment promotion claim that no country is absolutely "unpromotable." Each nation has its own selling points which must be recognized and developed, whether it is low labor costs, geographic proximity to markets, resource availability, technical capabilities, etc. It is the task of the investment promotion agency to recognize the basic strengths and weaknesses of the host country, and to direct its activities accordingly.

IV. INVESTMENT PROMOTION PROGRAM OPTIONS

Investment promotion is in almost every respect a marketing operation. The objective of the promoter is to sell a "product" (the host country as an investment site) and maintain or increase the host country's "market share" of total investments. The promotional activity employs the same fundamental sales techniques large manufacturers use to sell soap or small haberdasheries employ to sell clothing.

Extending the latter analogy, the haberdasher uses the following promotional methods. Advertising is intended to bring customers into the store to examine the merchandise. Pre-sales assistance is offered to give the customer advice and personalized service. Finally, special incentives in the form of discounts or sales are extended to complete sales transactions.

The marketing of investment sites is essentially no different. Potential investors are provided with mass-marketed or targeted advertising, pre-investment assistance, and a rich variety of investment incentives by host countries competing for relatively scarce investment projects. Most recent studies on this subject have concluded that competition for investment market shares has risen significantly in recent years, among developed as well as developing countries.

Several generic marketing principles also hold for investment promotion. First, the quality of the product is the most important selling point. Over the long run, the attractiveness of the investment climate relative to alternatives is the primary consideration in the minds of entrepreneurs. In their deliberations, customers clearly differentiate between products in terms of quality and place a premium on long-term reputations and experience. In addition, changes in quality (i.e., improvements in the investment climate) can be exploited for promotional purposes. Simply put, promotion activities are no substitute for improving investment conditions as a inducement to new investment. Effective promotion programs advertise objectively good investment conditions. Deceptive promotion can only work once.

A second instructive marketing principle is that, in almost every case, <u>promotional activities first generate increasing returns but eventually reach a point of diminishing returns</u>. The policy implication in this case is that all host country investment environments can be promoted to a certain extent and hence deserve some degree of marketing effort, but there is a point at which promotional activities yield increasingly smaller or even negative returns.

Therefore, it is essential that some determination be made in advance as to the appropriate level of effort/budget which would be expended on promotional activities based upon established objective investment targets (as discussed in the preceding section of this report). Failure to establish such tailored cost effectiveness standards could well undermine political support for these promotional activities.

A third working principle posits that <u>marketing budgets and strategies are most effective when they are based on the seller's competitive position and comparative market strength</u>. That is, new market entrants have to work harder to garner a share of the market. In addition, those whose reputations have been tarnished in some way need to undertake special efforts to overcome negative market responses.

<u>Basic Promotional Strategy: The Core Program</u>

Having taken the preliminary evaluative steps, the host country government can determine specific investment promotion activities. Host country authorities should consider developing a program which can be visualized as a set of concentric circles of activity: it would consist of a core promotional program, and sets of outwardly expanding efforts based on relative need and resources available. The core program would have the following components:

1. An in-country investment promotion office.
2. A system of branch promotion offices located in foreign countries.

3. Promotional material in the form of information packets and brochures, including a description of the country's investment incentive procedures or programs.

The host country investment promotion office would direct and manage the overall effort and would provide on-the-ground assistance to potential investors. This office could include separate departments to deal with indigenous and foreign investors, but most are designed to assist only the latter, who are more inclined to need and seek information on the business climate. In order to carry out its tasks effectively, the office would have to reach a "critical mass" in terms of personnel and financial resources. The appropriate "critical mass" would vary enormously as a function of the size of the economy, the targeted sources of investment, the degree of familiarity required on specific industries, and the language skills required. For a small country, a staff of as few as five to ten individuals could suffice, if staff quality is high and major assistance and cooperation are provided by other ministries and agencies. No investment promotion effort will succeed without well-qualified, appropriately-trained and experienced promotional personnel. <u>Promotion agencies must be staffed by highly-motivated, private enterprise-oriented individuals who have business experience (directly or at least by academic training) and excellent communication skills</u>. The SRI project team observed no single other factor as critical to investment promotion success as qualified personnel. As obvious as this observation might seem, the project team noted a remarkable lack of rigorous attention to appropriate personnel recruitment, training and development programs.

The overseas branch office system could be as modest as representation by commercial officers in foreign consulates and embassies, or as large as a multi-country set of independent investment promotion centers. For countries with limited resources, "investment authority" personnel could be stationed within government posts overseas or with trade promotion offices. In this area, considerations of economies of scale (which suggest grafting investment promotion efforts onto existing commercial representation) must be balanced against the utility of directing potential investors to offices whose sole purpose is investment promotion and assistance. (It should be noted, however, that the SRI project team was not impressed with most promotional activities currently undertaken by embassies or consulates. The reasons for the weakness of such representation are varied. However, a fundamental difficulty relates to the fact that diplomatic offices report to foreign ministries and, therefore, often give investment issues short shrift. In turn, investment authorities do not communicate as effectively as they should with personnel not directly responsible to them.)

The requirement for printed promotional material is straightforward. However, the quality and availability of informational brochures provided by various host countries varies enormously, ranging from nonexistent to copious to extravagant. The basic promotional package would include a general brochure on the basic business climate (probably illustrated to highlight positive factors) and a document spelling out in some detail the host country's policies and procedures relating to private sector investment. An obvious but often overlooked point is that sufficient quantities of this material must be made readily available to all offices and individuals responsible for investment promotion.

The cost of the "core program" is indeterminant in the abstract. In many cases, investment promotion activities are carried out totally or in large part by government ministries, which provide personnel and in-kind assistance, and assume fixed costs such as office space.

Given the caveat of enormous variations in cost, the following table illustrates the amount of funds required to maintain a "bare-bones, no frills" investment promotion activity. The fixed annual cost for such an effort, providing nothing more than basic information and counselling, is approximately one-half million dollars. This figure might, therefore, be considered the minimum threshold for a promotional program, excluding the cost of incentives.

This overall figure for the core program represents the annual budgetary cost that must be sustained over an extended period of time. Too often investment promotion activities are tried for one or two years and then dismantled after limited "concrete" results are observed or even when

CORE PROGRAM: ILLUSTRATIVE MINIMUM ANNUAL BUDGET

I.	Investment Promotion Home Office	
	Professional Staff (5, average p.a. salary, benefits @ $20,000)	$100,000
	Secretarial, Clerical Staff (5, average p.a. salary, benefits @$10,000)	50,000
	Imputed office rental (2,000 sq. ft. @ $15/sq. ft.)	30,000
	Office furniture and equipment rental	10,000
	Telephone, telex, and postage	20,000
	Materials and supplies	5,000
	In-country travel, expenses	5,000
	Foreign travel, expenses	30,000
	Subtotal	$250,000
II.	Branch Offices (Consular Representation)	
	Professional Staff (one-half man/year @ 10 consulates @ $30,000 p.a. salary, benefits)	$150,000
	Direct Expenses (telephone, telex, postage, local travel, etc.)	20,000
	Imputed Overhead Costs (33% of salaries, benefits)	50,000
	Subtotal	$220,000
III.	Promotional Material (2 brochures @ 50,000 copies)	
	Research and writing	$ 10,000
	Artwork, layout and typesetting	5,000
	Printing: general brochure, 16-page, 3-color	5,000
	investment handbook, 32-page, black and white	5,000
	Subtotal	$ 25,000
	TOTAL CORE PROGRAM BUDGET	$495,000

investment flows commence (on the assumption that the task is completed). Such decisions are unfortunate, since the most successful promotion agencies have indicated that marketing efforts should be sustained indefinitely and strengthened over time, although not necessarily through infusions of greater financial resources.

Before proceeding any further, one final point on the issue of commitments of resources is in order. In terms of importance, quality of personnel and program vastly outweigh the size of staff. One savvy, aggressive investment promoter with a WATTs-line telephone may well generate more investment deals than an entire building full of underqualified staff members unfamiliar with business practices. This is not to say that small programs are necessarily better, or that large programs are necessarily inefficient, but only that real financial resources should be directed at personnel and programs of high caliber. It also suggests that it might be possible, through careful selection of staff, to establish an effective core program at a reasonably contained cost.

Incremental Programs and Projects

Once the core program has been carefully designed and put into place, incremental promotional efforts of various magnitudes can then be considered, representing bands of activities surrounding the nucleus promotion organization. The range of options available is large and varied, as are the financial implications.

Branch Offices: If the host country investment authority wishes to increase its contacts with foreign firms in order to attract new investments, the establishment of independent branch information/assistance offices could be considered. According to U.N. figures, as of mid-1983 some fifty nations maintain "investment offices" of some kind in New York City alone. Many of these missions are tied to trade and tourism offices or to U.N. missions and/or foreign consulates. To seek out potential investors, it is necessary to maintain a presence in the major centers of capital and investment.

The basic annual budgetary cost for a relatively modest investment promotion office in New York City is shown on the following page. The "bottom line" cost comes to about $250,000 per year. Such an office could act as an investment information and service center for the entire United States, and would be staffed with several highly-qualified professionals conversant with both the host country investment climate and the operations and objectives of U.S. firms.

Developing countries with limited resources might consider setting up a New York office and a European-based office (comparably priced) for a total annual cost of about $500,000. Other countries might add additional offices in the United States (e.g., in Chicago, Miami, Los Angeles), in Europe, or in Japan. The Industrial Development Authority of Ireland maintains perhaps the most extensive system of offices worldwide, with eight offices in Europe, eight in the United States, one in Japan and one in Australia. For most developing countries, however, the costs of maintaining such a system would be prohibitive, so branch office locations must be chosen carefully, taking into consideration such factors as geographic proximity and the strength of economic relationships. African countries would naturally tend to locate their offices in Europe, Latin American countries in southern U.S. cities, Asian countries in Japan and the U.S. West Coast, and all countries in New York City.

The branch offices would carry out targeted marketing efforts and act as regional centers for inquiries and assistance networks. The most efficient network system could employ what could be called the "funnel approach." In this system, overseas embassies, consulates or trade centers in countries or areas not covered by branch offices would provide basic information and would refer serious prospects to the regional branch offices. The latter would then offer the investor more detailed information and counselling, but eventually would refer the prospect to the home investment office to complete the process. Some form of referral system along this model provides for increased communications among promotion offices and enhances the prospects for cooperation rather than competition, often lacking in regionally or functionally separated marketing operations.

NEW YORK INVESTMENT PROMOTION OFFICE BUDGET

Personnel	
Office Director (Salary & benefits)	$ 60,000
Deputy Director	40,000
Administrative Assistant	30,000
Secretary	25,000
Office Rental ($40/sq. ft. x 1,000 sq. ft.) (good, central location)	40,000
Furniture	5,000
Copy machine (rental)	4,800
Typewriters (2)	2,400
Telex/telephones	3,200
Insurance	1,000
Office materials & supplies	5,000
Memberships (Chambers of Commerce, etc.)	2,000
Travel to Host Country (1-2 trips) (range: $1,500-$10,000)	5,000
Local travel and entertainment	25,000
Contingencies	5,000
Total	$253,400

Advertising: Although advertising is expensive and measuring its effectiveness is highly problematic, nearly all organizations, whether corporations, interest groups, political parties or governments, agree that advertising can produce results. The art is to design and undertake an advertising campaign which not only reaches the appropriate audience at the appropriate time, but also effectively induces the target audience to take the desired course of action--purchase brand X soap, vote for candidate Y, or invest in country Z.

Corporate executives who make investment decisions are among the most sophisticated of potential audiences, and hence advertising campaigns must be designed accordingly. The following table is illustrative of advertising costs for the printed media, often used for investment promotion.

Clearly, conducting a systematic marketing campaign through the business-oriented media is no small operation in terms of financial requirements. Considerable expenses other than direct ad placement costs would also be incurred. Officials at major public relations firms suggest that conceiving and implementing a moderately-sized marketing campaign would entail an annual fee of approximately $100,000 for the services of public relations firms. Comparable fees for advertising firms might also be required. In sum, the budget for a non-extravagant effort to advertise in the United States and promote a new investment push in any given country would run on the order of one million dollars. The opportunity cost of such a budget is considerable, since it would be roughly sufficient to support the home and branch offices of a modestly sized investment promotion organization.

However, targeted advertising in selected trade magazines is often a cost-effective use of print media. For example, a promotion agency seeking to attract high technology investments might undertake an advertising campaign which specifically addresses electronic industry questions in those publications read by high technology sector executives. Such highly-focused approaches are more likely to generate investor interest for substantially less cost than more general mass media campaigns.

MASS MEDIA

Wall Street Journal:	full page, national edition:	$62,850/day
	full page, eastern edition:	$26,340/day
New York Times:	full page, national weekday:	$25,800/day
	full page, national Sunday:	$28,448/day
Washington Post:	full page, weekday, Sunday:	$23,917/day
	full page, Monday business:	$11,137/day
Chicago Tribune:	full page, weekday:	$19,300/day
	full page, Sunday:	$27,400/day

BUSINESS MAGAZINES

Business Week:	full page, N.A. edition:	color	$33,940
		BL & WH	$22,330
	regional edition:	color	$ 2,300
		BL & WH	$ 1,510
Forbes:	full page, black and white		$18,500
	full page, two-color		$23,120
	full page, four-color		$28,100
Fortune:	full page, black and white		$21,740
	full page, two-color		$27,180
	full page, four-color		$33,000
Economist:	full page, world edition:	BL & WH	$ 5,300
		color	$17,000
	N.A. edition:	BL & WH	$ 3,000
		color	$ 3,300
Nation's Business:	full page, black and white		$13,100
	two-color		$16,370
	four-color		$18,990

TRADE MAGAZINES

Oil and Gas Journal:	full page:	black and white	$ 2,950
		two-color	$ 3,225
		four-color	$ 4,000

DIRECT MAIL ADVERTISING: FORTUNE 1,000

Fortune list and postage:	$210	
Letter Printing:	$200	
Brochure	$2,000	
Total Cost	$2,410	$ 2,410

Opinion sampling techniques can also be utilized in various targeted markets in order to help maximize effective use of advertising. Such surveys can help establish the prospective investor's level of knowledge or identify misperceptions of a given country, in order to direct the advertising campaign's focus. For example, a targeted advertising campaign in electronic industry publications might be rendered ineffective if the average prospective investor regards the general investment climate to be inhospitable, irrespective of individual incentives offered.

A number of other advertising methods can be employed as substitutes or supplements to mass media advertising. Direct mail advertising is much less expensive and reaches a smaller but more targeted audience. Direct mail approaches are generally nonproductive if sent to unnamed "Dear Sirs," and so direct mail consultants (with high fees) are often required to generate tailored mailing lists.

Business executives are often skeptical of the validity of advertisements placed by host countries promoting investment, and hence tend to pass them by. They more often do take note of articles on investment climates written by business or economic reporters. As a result, one effective method for drawing the business community's attention to a host country's investment climate is to promote "unsolicited" press coverage and reporting. This can be accomplished by several means. First, investment promotion authorities can legitimately sponsor business "press tours" in which a select number of reporters or editors are provided with transportation and living expenses and are briefed on business conditions and economic achievements in the host country. While results are not guaranteed as to how the climate is described, these tours tend to produce survey articles by participants, or at a minimum a greater depth of understanding of host country opportunities and problems on the part of the working press.

An alternative to the press tour is the "media event." Most often these refer to announcements of economic progress, new policy pronouncements or major speeches on the achievements of the host country.

These "events" could take place either in the host country itself, or in foreign countries where press coverage is sought. Very often "neutral organizations" such as chambers of commerce, trade associations, or bilateral commissions make themselves readily available to provide a forum for such events. Alternatively, media and corporate attendance at one-day conferences on the "investment climates" of host countries normally assures both direct and indirect (word-of-mouth) advertising.

One important but sometimes neglected activity for any promotion agency is the development of close working relationships with the host country media. The generation of public support is often a crucial ingredient required for any investment program to be successful, particularly in countries where attitudes toward private enterprise have been or are generally negative. Therefore, investment authorites should attempt to keep the public informed on the activities and objectives of promotional programs. However, care should be taken to avoid "premature" publicity. In almost every country examined by the SRI project team, examples were given where public announcements regarding new investments were made before firms had reached final investment decisions, and the untimely publicity often convinced the firms to go elsewhere.

The discussion thus far has concentrated on relatively formal methods of promotional advertising. However, perhaps the most effective, willing and motivated promoters of any investment climate are private sector executives. Potential investors tend to value most the advice and counsel of their friends, colleagues and professional associates. Therefore, business executives can serve as powerful advocates of the investment climate, and more often than not they are willing to do so gratis.

Efforts to enlist the services or "good offices" of current investors for promotional purposes need to be well-conceived, but need not be elaborate. Local chambers of commerce, for example, are generally willing to sponsor in-country seminars for visiting executives. In addition, individual businessmen or businesswomen might make themselves available to respond to prospective investors' questions -- thus serving as independent reporters of local conditions. Finally, executives on business trips or home leave might be asked to give formal presentations to investment promotion seminars, or to sit down at lunch informally with a select number of interested prospective investors. Many variations of this type of "pro bono" assistance are possible and can yield significant "word-of-mouth" results.

One particular pool of resources which can be tapped are firms which sell various services to prospective investors. Banks and law firms in both host and home countries commonly offer their facilities as sites for investment seminars. Similarly, lawyers, accountants or consultants participate in investment missions or prepare and/or translate investor guides. These services are generally rendered without any fees being charged, since the firms benefit from contacts made with potential clients or from implicit advertisements in prepared documents.

A new form of investment promotion that has developed in recent years is that of the "telemission." This technique utilizes advanced satellite communications technology to bring two or more geographically separated groups together, visually as well as audibly, as if they were physically in the same conference. "Telemissions" of this sort have been conducted for U.S. investors interested in Egypt and the Caribbean Basin. The costs of such efforts are high: the U.S.-Egypt "telemission" reportedly cost $250,000 for a multi-center conference lasting two hours. The fixed cost for a permanent teleconference facility at any given location is put at $600,000. Technology of this sort may represent the wave of the future in terms of "instant, intimate communications," but it will never replace the central importance of basic business conditions in the investment decision process.

Pre-Investment Assistance: Pre-investment assistance refers to those activities directed toward aiding potential investors who have made a degree of commitment to pursue seriously new investment opportunities. This type of assistance generally falls into one of three categories: counselling, research studies, and cost defrayment.

Pre-investment counselling can be offered at all stages in the decision-making process, and can range between minimal efforts and major undertakings on the part of investment authorities. Initial efforts would serve to provide individual investors with general or specific information on the investment climate and regulatory environment. Next, counsellors can offer referrals or make appointments for investors visiting the host country. Counsellors can then give investors step-by-step guidance on registration and/or incorporation procedures, reputable suppliers, joint-venture partners, and start-up considerations. Some counsellors even prepare documentation on behalf of new investors. Finally, investment counsellors can elect to stand by to act as ombudsmen when conflicts arise between investors and government agencies before or after the venture has been initiated.

Investment counselling is particularly important for smaller firms with limited resources or experience. Large companies may or may not avail themselves of the information provided by counsellors, although they do often use the counsellors as a sounding board in setting the tone and pitch of their investment applications before submitting them to official authorities. While assistance to individual firms might be carried out by different individuals or offices with specialized expertise, it is generally most effective to assign a single home country and host country counsellor to each firm to serve as a general point of contact. The cost of counselling is indeterminant, and is generally absorbed within the overall budget of the promotional agency. For accounting and control purposes, however, costs could be allocated on the basis of hourly or daily rates.

Research studies have the dual objectives of whetting the appetites of prospective investors (akin to advertising) and providing detailed information which is useful or critical in the decision-making process. The topics covered by research studies generally focus on opportunities for private enterprise in different sectors or industries. Examples of sectoral surveys might include the agribusiness prospects in Costa Rica, infrastructure development in Sri Lanka, manufacturing opportunities in Egypt, or the service sector outlook in Taiwan. These surveys assess the present characteristics and future projections for individual economic sectors, either broadly or narrowly defined. They seek to present information on needs and opportunities, including examinations of demand-side and supply-side variables.

Industry studies are generally a more specifically focused form of sectoral survey. Examples here might include health industry projections in Kenya, microprocessing in Ireland, or prospects for the textiles industry in Haiti. These studies place a greater emphasis on microeconomic information, such as industry wage scales and skill level availability, complementary infrastructure, local sales opportunities, and distribution systems.

In addition to sectoral or industry studies, selected research projects on specific business climate characteristics can be conducted to generate information and analysis on special factors of interest to potential investors. These topics would cut across industries and sectors and concentrate on such issues as labor market conditions, consumption patterns, utility rates or land usage patterns.

The research studies mentioned above can be combined into a category called "pre-feasibility" reports. They are typically carried out on behalf of the host country or donor agency and then made available to all interested investors. They are intended to provide sufficient background data to encourage prospective investors to initiate their own formal project evaluations or feasibility studies. These "pre-feasibility" analyses could be carried out by host country research groups, official bodies or international consultant organizations. The costs of such studies are generally high, falling into the $50,000-$200,000 range, particularly if they are conducted by outside organizations. Given these costs, a great deal of prior consideration should be given to the ultimate purpose and concrete uses of studies well before they are commissioned. It is particuarly important for these studies to be carried out with a strong degree of objectivity, lest they be perceived by investors as self-serving and therefore lacking in credibility.

In the course of its research on actual country experience, the project team discovered that the preparation of general sector studies is a common practice, and that the record on the utility of these exercises is mixed. Very often the studies are poorly prepared and are hence of little value to prospective investors. In other cases, even well prepared reports have not been used effectively, since adequate follow-up activities were not developed. Instances were cited where investor interest was generated by sector studies, but more often the SRI project team concluded that these efforts consumed scarce promotional resources with only a limited payoff, in part as a result of poor study management. In terms of budgetary allocations, it is generally appropriate to shift emphasis away from these forms of pre-feasibility studies and toward actual feasibility studies, which are of greater use to prospective investors.

<u>Investment feasibility studies or project evaluations</u> are normally the last form of research undertaken by firms prior to a "go" or "no-go" decision. These studies are company-specific, and are most often carried out by the prospective investor at the company's expense, which is indicative of the firm's level of commitment. However, in some instances official or quasi-official agencies (the IFC, OPIC, investment authorities, etc.) underwrite all or a portion of expenses incurred. Feasibility studies should cover detailed market prospects, plant siting alternatives, production cost estimates, engineering and flow-process evaluations, capital cost estimates, return on capital calculations, cash-flow analyses, and so forth. Preparation of these reports requires inputs of proprietary information which may be sensitive <u>vis a vis</u> both competitors and the host country government, and so firms tend to be loath to conduct joint studies with official agencies. Under these circumstances, methods can be devised to compartmentalize the research in order to protect proprietary information, similar to the conduct of classified government research.

Pre-investment <u>cost defrayment</u> refers to cash grants, subsidies, or other forms of reimbursement to firms unable to shoulder the entire financial burden for pre-investment activities. In addition to financing all or part of costs incurred for preliminary research, investment promotion authorities or donor agencies might also provide business executives (from smaller companies) with travel allowances, funds for in-country operating expenses, or payments in kind. The latter category would include such items as temporary office space, transportation or secretarial assistance.

Investment Incentives and Disincentives: The final form of investment promotion activities is incentives provided by the host country government to private sector entrepreneurs. Governments can utilize an extensive battery of incentives, most of which imply some form of direct or indirect preferential treatment to attract capital investments.

In general, investment incentives are those actions taken, coming into effect when an investment decision is consummated, to influence investment decisions through their impact on relative price or cash-flow variables. They have also been defined as any actions which have the effect of increasing the return on capital of given investment projects. Alternatively, investment disincentives are those actions which reduce projects' return on capital.

Investment incentives fall into a vast array of instruments which can be characterized in several ways. One classification system categorizes incentives as they would affect a corporation's balance sheet and income statement, i.e., those affecting revenues, those affecting inputs, those affecting components of value added, and others. The list of possibilities is extensive, as is shown by the following table.

I. Incentives Affecting Revenues

1. Tariffs (protection from import-competition)
2. Differential sales/excise taxes
3. Export subsidies
4. Quotas
5. Relief from price controls
6. Government procurement preferences
7. Guarantees against government competition
8. Prior import deposits

II. Incentives Affecting Inputs

1. Tariff reductions
2. Wage controls
3. Price controls
4. Multiple deductions for tax purposes
5. Cash or in-kind grants for R&D

III. Incentives Affecting Components of Value Added

A. Capital

1. Direct subsidies (cash grants, tax credits, investment allowances, and subsidized leasing)

2. Cost of capital goods (tax exemptions on equipment, subsidized buildings, subsidized cost of transportation)

3. Cost of Debt (subsidized loans, loan guarantees, foreign exchange risk coverage)

4. Cost of Equity (subsidized equity, exemption from capital gains taxes, dividend tax waivers, guarantees against expropriation)

5. Corporate tax (tax holidays or reductions, accelerated depreciation, special deductions or valuation practices, guaranteed tax rates)

B. Labor

1. Wage subsidies
2. Training grants
3. Relaxation of industrial relations laws

C. Land

1. Cash subsidies for land purchase or rental
2. Land tax exemptions or rebates

IV. Other Incentives

1. Guarantees against expropriation
2. Waivers from foreign ownership limitations
3. Free trade zones
4. Preferential access to foreign exchange
5. Guaranteed monopolies

These and other investment incentives have been and are being offered by host countries (or regions within them) to attract capital inflows. In many cases incentives are targeted for ventures in "preferred" sectors or industries.

Investment disincentives are often the reverse of those listed above. The most common disincentives now being employed are ownership limitations and performance requirements, the latter specifically focusing on export and local content quotas. Very often host country governments deploy a mixed set of incentives and performance requirements. Governments seek new investments and at the same time attempt to regulate the activities of firms in order to reap greater benefits. In those cases, fiscal incentives are extended on the basis of quantitative performance targets (e.g., levels of employment, foreign exchange earnings, etc.) set or achieved by investors. The ultimate impact is an enormously complicated array of price distortions which must be evaluated by prospective investors.

Corporate attitudes toward investment incentives are mixed (views on disincentives are straightforward). There is an almost universal agreement that the overall operating conditions and political and economic stability of the host country -- not preferential arrangements -- are of paramount importance in investment decisions.

Corporate executives often tend to view "special" incentives as a form of government intervention and interference with private market forces, which could prove counterproductive in the long run and could be easily revoked. However, corporations do generally benefit from investment incentives in developing countries. Recent studies also confirm that "investment incentive wars" are currently being waged among host countries given the overall decline in foreign investments.

> [Among the rules of international business] . . . one honored dictum is that managers making investment decisions should consider investment incentives . . . as insignificant variables. Economic stability, infrastructure, production costs, and nearness to market should always top the list of factors evaluated, with incentives seen as nothing more than a happy windfall . . . shrewd executives have been breaking this rule for some time and benefiting from an intense bidding war conducted by governments eager to attract companies and ready to use whatever incentives they can think of.[8]

In the final analysis, investment incentive programs are taken into consideration by potential investors, particularly those smaller firms seeking to site a single operation in one of several possible locations. In these cases, the relative attractiveness of incentive packages could be quite significant.

Even in the recent past, incentives were generally not considered an important factor in investment decisions, but rather as "icing on the cake." Given the rising level of competition for investment in recent years, however, the significance of incentives has increased considerably. An extensive analysis on incentives recently conducted by the International Finance Corporation of the World Bank group came to the following conclusions:[9]

1. Countries actively compete for investment in a manner similar to that employed by manufacturers competing for market shares, and competition among countries for foreign investment has often been almost exclusively associated with higher levels of incentives.

2. In most cases studied, incentives were effective in altering the location decisions of foreign investors, particularly among countries with comparable business climates and/or in the same region.

3. Changes in incentive packages (typically an increase) in one country are likely to provoke a similar response in competing countries.

4. Since most incentive programs are administered on a case-by-case basis where certain information is confidential, it is nearly impossible to measure incentive levels between countries or over time.

To the host country. incentives constitute a "sunk cost" incurred to induce capital inflows and domestically based productive activities. Often these costs can be recouped in a relatively short period of time, and sometimes they cannot. Some forms of incentives may be preferable from a domestic political perspective (particularly those which are relatively hidden, such as subsidies) but make little economic sense. The cost of other incentives, such as cash grants, might be recouped easily from the economic activity and taxes generated by new investments, but may be impossible to provide in view of adverse public reactions.

V. CONCLUSIONS ON PROGRAM DESIGN AND EVALUATION

The ultimate measure of the performance of investment promotion activities is the number and size of new investments in the host country. There is no practical ex post facto method to determine the relative impact of promotional efforts on investment decisions as distinct from the general investment climate or other factors. Most corporate planners would necessarily downplay the importance of host country promotion, since they would prefer to conclude that the investment decision was made on the basis of an objective assessment of host-country conditions.

Attempts to trace the causal factors of the decision process could prove to be relatively unproductive exercises, since entrepreneurs base their decisions on assessments of a complex mix of objective and subjective criteria. The role played by investment promotion in these assessments is indeterminate. The credit that can be legitimately claimed by investment authorities is in some cases substantial, and in others minimal.

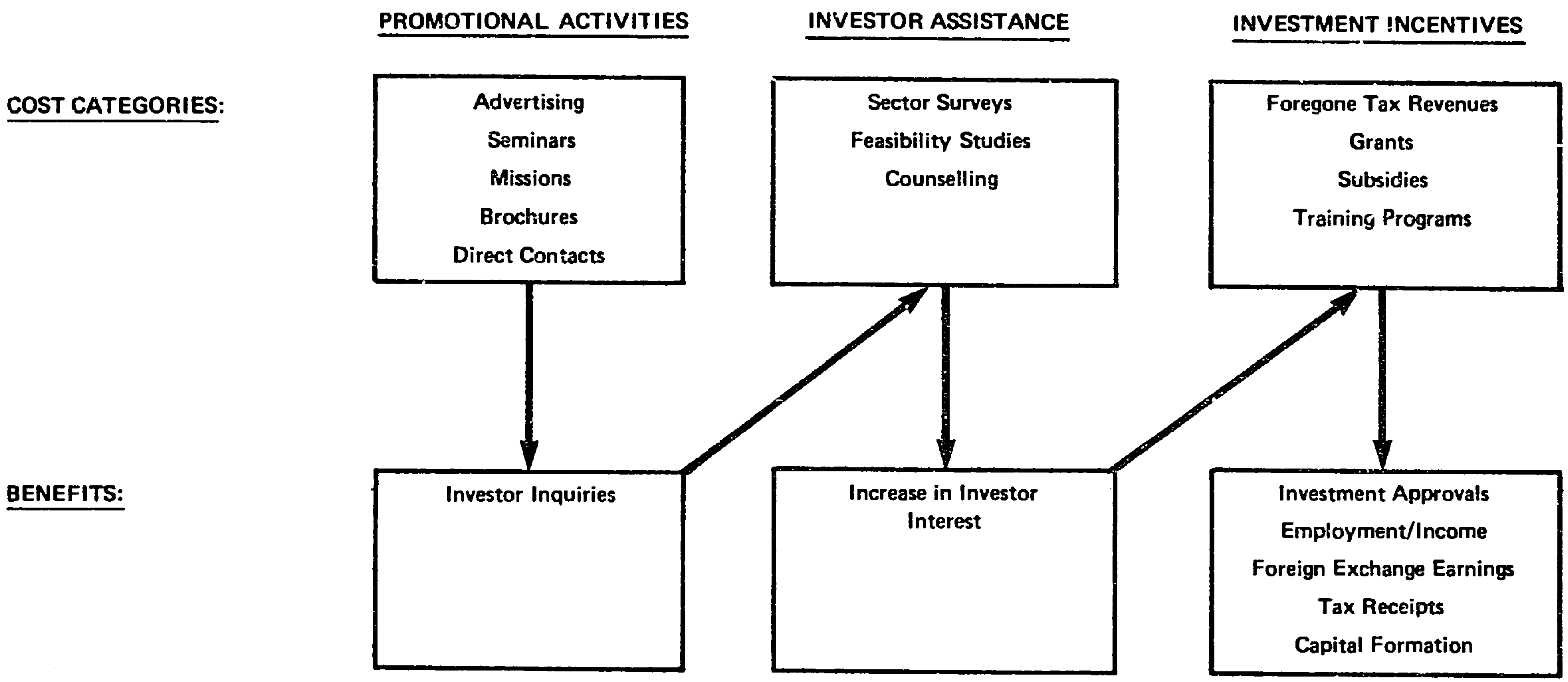
However, several simple and inexpensive procedures can be built into the promotional activities. For example, promotion offices could keep logs on the numbers and types of firms that have initiated inquiries. These logs could also specify the questions asked and the forms of services provided, thereby offering valuable feedback to investment authorities. In addition, advertisements can and should include clear references as to where further information can be obtained. A record would then be kept of inquiries generated by each advertisement effort. Similar records could be kept for seminars, investment missions, direct mail and other techniques employed. This data could then be used to examine the relative effectiveness of the different promotional techniques, which could be examined in light of the costs incurred for each. Eventually, the individual components of the promotion program could be assigned a budget commensurate to their level of performance.

Once potential investors have been identified, a separate system could be maintained to keep track of new ventures as they proceed through the investment process. This would, again, vary according to the number of steps required of investors and government authorities. With such a system, investment counsellors could monitor the progress of new projects and intervene in the process when investor interest waivers or unwarranted delays emerge in the approval process.

Perhaps the best feedback data can be gathered at the final stage of the investment process--incorporation or registration. All companies setting up business in the host country must fill out various applications in order to receive final approval. These applications could include a simple one or two page survey soliciting corporate opinions on and recommendations for the promotion system. In this survey, investors would be asked to specify the form of their interactions with the investment authority, the quality of service provided to them, and ways in which they feel investment promotion and assistance could be improved. To encourage frank responses, the survey would remain confidential, would not be a part of the investor's permanent registration record, and would in no way influence the application outcome. This simple, relatively costless procedure could create valuable information on the relative utility and effectiveness of different components in the promotional system.

Since promotion programs seek to generate and sustain investor interest, and since new investments create economic gains, it is possible at least in a notional sense to measure the benefits and costs of any investment promotion program as a whole, as well as a number of components within it.

Promotional efforts have both quantifiable costs and quantifiable benefits. The benefits sought are increases in the activities of private enterprises, measured in terms of increases in employment, the amount of capital invested, or the level of foreign exchange savings or earnings associated with new ventures. Values can be assigned to each of these objectives. On the other side of the ledger, costs can be measured in terms of the budgetary outlays spent by the investment authorities. Over time, therefore, one can calculate the overall benefits derived from new investments (e.g., number of new jobs created times the average prevailing wage rate) and compare those benefits to the costs of promotional efforts. The following chart illustrates how these cost-benefit factors might be disaggregated.



COSTS AND BENEFITS ASSOCIATED WITH INVESTMENT PROMOTION ACTIVITIES

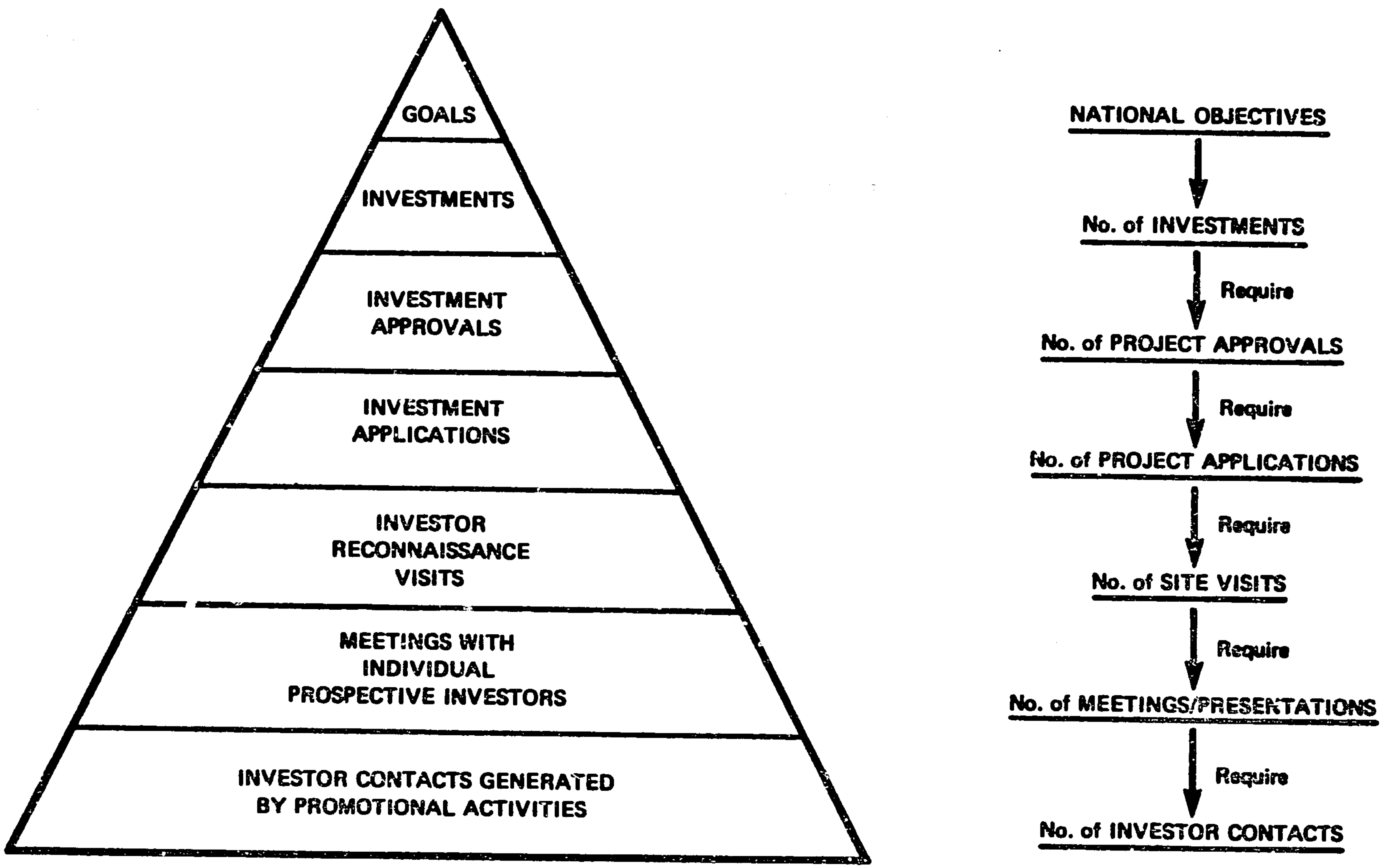
Although some form of cost/benefit calculation would establish a degree of accountability on the part of promotion agencies, it might also create certain problems. First, it assumes that promotion agencies are principally responsible for new investments or the lack thereof. As mentioned previously, even the efforts of well-managed promotion agencies can be stymied by a poor business climate or by bureaucratic inertia. If unrealistically high expectations are set for performance, the promotion agency might end up spending more time promoting its own success than promoting the investment climate. While performance targets represent a useful technique for monitoring promotion programs, they should be managed carefully to avoid situations in which quality would be sacrificed for quantity.

Monitoring Promotion Performance

Instead of developing cost/benefit ratios, perhaps a more useful exercise would be the creation of a framework by which the effectiveness of individual promotional activities can be tracked. Although these frameworks would vary to fit the unique experiences of individual countries, they could be based on a general conceptual model which follows the investment process. This model can be visualized as a pyramid which captures the investment promotion process, as is demonstrated in the next figure.

At the top of the pyramid are the host government's national economic goals--a given level of employment creation, foreign exchange earnings, etc. An investment authority helps meet these national goals by generating investments. In order to achieve this goal, a certain number of investment project approvals are required, varying according to the number and size of new investments. Since prospective investments do not all come to fruition, achieving the desired number of investments would call for a larger number of investment approvals. In turn, since only a certain percentage of investment applications are approved, achievement of investment approval goals requires the generation of considerably more investment applications than approvals sought. Similarly, an investment agency could (with experience) project that a certain number of prospective

THE INVESTMENT PROMOTION PROCESS



investor reconnaissance visits to the host country are required, a larger number of meetings with individual prospective investors, and an even larger number of initial investor contacts which are to be generated by promotional activities.

The size and shape of investment promotion pyramids would differ among countries according to the magnitude of the goal sought, the relative attractiveness of the investment climate, and the efficiency of the promotional authority. For countries with more attractive business climates and/or more efficient promotion agencies, the base of the pyramid would be more narrow, since fewer initial contacts would be necessary to reach the desired number of new investments. For any given country, the development of an investment promotion pyramid would depend on statistical information (as described above) collected over a number of years, since the lead time associated with investment decisions varies considerably.

Evaluation Criteria

Each proposal for an investment promotion project or program should be judged on its own merits, acknowledging differences in local conditions, needs and past performance. Therefore, efforts to impose a single, rigid set of criteria for new proposals would be ill-advised. Since investment promotion activities tend to be most effective when they are based on common sense, and pragmatically address problems and seize opportunities as they arise, it is appropriate that current or new efforts be judged accordingly.

Notwithstanding the recommendation that governments and donor agencies should consider proposals on a case-by-case basis, a relatively simple and consistent set of guidelines can be used for evaluating proposals for both overall promotion programs and individual program components. The following evaluative checklist covers those elements which the SRI project team has found to be most essential to the success of investment promotion programs. The checklist could help in both program design and evaluation. It could also be modified into a scoring system for rating alternative proposals. Individual AID missions could weight the various items on the checklist in accordance with their importance and relevancy to the country in question. The first set of criteria relate to proposals for general support of promotion organizations and efforts. The second set refer more specifically to individual program components. Most of these factors relate to qualitative rather than quantitative assessments.

I. OVERALL PROMOTION CRITERIA

A. CLARITY AND MEASURABILITY

1. Clearcut goals and objectives have been determined.

2. Quantifiable set of final and interim targets has been established.

3. Goals are consistent with realities of investment climate.

4. Goals are consistent with other economic development policies.

B. FLEXIBILITY

1. Includes provision for modifying program if targets are not met.

2. Includes provision for adjusting program in response to change in investment climate or in economic conditions.

3. Incorporates administrative flexibility.

C. INSTITUTIONAL CAPACITY

1. Structure and authority of promotion agency are consistent with program goals and objectives.

2. Size and budget of promotion agency are commensurate with goals and objectives.

3. Staff is well-trained and sensitive to needs of private sector investors.

4. Relationship of promotion agency with other relevant officials and agencies is productive and well-defined.

5. Mechanism exists for coordination of investment related activities.

D. FEEDBACK MECHANISMS

1. Promotional efforts are supported by accurate and up-to-date information on the investment climate.

2. System for tracking potential investments through the decision process is included in the program.

3. Program provides mechanism for input and assistance from local and foreign business community.

II. PROGRAM COMPONENT CRITERIA

A. PROMOTIONAL LITERATURE

1. Data to be used is as current and as accurate as possible, and is based on and/or cites unbiased sources.

2. Material states clearly the investment objectives of the host country government.

3. Material addresses investors' major concerns about the investment climate.

4. Primary target audience has been pre-determined.

5. Material is/will be well written, illustrated and translated, and uses standard business terminology.

6. Literature includes clear references for obtaining further information, allowing for identification of inquiries generated.

B. ADVERTISING/MEDIA CAMPAIGNS

1. Campaign goals are clearly and realistically stated.

2. Rationale is given for the use of this technique in addition to or in lieu of less expensive alternatives.

3. Target audience has been identified and can be reached effectively through the medium selected.

4. Results of previous advertising have been assessed, and/or the current program includes pilot-testing.

5. Creative talent budgeted for program design and execution is adequate.

6. Follow-up activities have been well-planned, including the handling of investor contacts and ex post evaluation of advertising effectiveness.

C. OVERSEAS OFFICES

1. Proposed office is an integral part of an overall promotion program, and is deemed necessary to achieve stated goals.

2. Lines of authority to the senior management of the sponsoring agency are clear and direct.

3. Expectations for the office's performance are realistic.

4. Funding is secure for at least three years.

5. Target audience has been well-defined, and can best be reached from the office site identified.

6. The office will be staffed with experienced personnel familiar with the home country business community, and/or will use local experts for program execution.

7. The office plan benefits from an assessment of the experience of precedents.

8. Unnecessary expenses will be avoided, and the initial level of activity will be modest.

9. The plan identifies means by which to evaluate the performance of the office.

D. PRESS/PUBLIC LIAISON

1. Program goals are clear and achievable, and are consistent with the promotion agency's charter.

2. Press/public liaison staff are professionals with previous public relations experience.

3. Audiences have been narrowly defined, and can be effectively reached through techniques to be employed.

4. Plans include the utilization of existing business/other organizations and executives.

E. SEMINARS AND MISSIONS

1. Goals are narrowly defined and complement other promotion activities.

2. The programs include the appropriate mix of government/business/other spokespersons, who are credible and effective communicators with the intended audience.

3. The forum, place and dates involved are appropriate to advance the interest of the target audience.

4. Invitations will be carefully prepared and responses will be monitored closely.

5. Overseas offices play a direct role in program design, execution and follow-up.

6. Events allow sufficient time for conferences between promotion officials and individual prospective investors.

F. FEASIBILITY STUDIES

1. Eligibility criteria are consistent with specific investment goals (e.g., sector or regional targets).

2. Application/approval process to study grants are sufficiently simple to encourage use of the program, but include mechanisms to avoid potential abuses.

3. Data to be generated via feasibility studies are not readily available in a form useful to prospective investors.

4. Includes provisions for the compartmentalization of proprietary information to protect prospective investors.

5. Program includes mechanisms and/or assurances for cooperation by government agencies responsible for relevant statistics collection and analysis.

6. Cost-sharing provisions are sufficiently attractive to prospective investors but reflect a growing level of financial commitment by investors.

7. Includes reference system to avoid duplicative efforts.

In addition to these general evaluative criteria, the SRI project team has on the basis of field research also identified a number of fundamental principles which should underlie all investment promotion efforts. These principles should help guide the design and development of new promotional activities in virtually any national context. They are necessarily general and somewhat simple. Nevertheless, the project team was repeatedly struck with the fact that these common sense guidelines had been often overlooked by government officials and other responsible parties in their haste to promote investment. Most of the problems encountered in the design and execution of those investment promotion activities reviewed ultimately could be traced to a violation of one or more of these principles.

1. <u>Before promotional programs are developed, an honest examination of the host country's investment climate assets and liabilities should be undertaken</u>.

Investment promoters should have an objective picture of the nature and quality of the "product" they are selling. Those charged with promoting investment must also truly understand the prospective investor's perception of the host country investment climate. The basic policies and bureaucratic management affecting private enterprise are fundamentally more important to attracting investment than are investment promotion activities. Even the most sophisticated promotional programs cannot sell a bad investment climate to anyone other than relatively naive entrepreneurs. Crafting and maintaining a consistent, coherent investment policy is the single most effective action a host country can take to promote investment. Promotion efforts must necessarily capitalize on a country's strengths. Where problems are identified, they should be corrected and then the "new" reality should be promoted.

2. <u>Investment promotion agencies should be involved in the development and review of investment policy</u>.

Government ministries should seek to integrate the promotion agency function into the investment policy review framework, so as to benefit from the promoters' views of the host country investment climate. In turn, the promotion agency should seek to serve as interlocutor between relevant government ministries and investors. Effective promotion agencies must be in a position to help identify and remove investment barriers, not gloss over then with promotion techniques.

3. <u>Investment promotion activities should be tailored to a host country's national character and objectives</u>.

No single program of promotion technique necessarily works for every country. Rather, the most effective programs are those which are carefully crafted on the basis of the country's economic goals and investment priorities. All countries have some marketable investment attributes. These should be identified and promoted.

4. <u>Investment promotion activities should be staffed by highly-motivated, private enterprise-oriented individuals with business experience (directly, or at least by academic training) and excellent communications skills</u>.

In addition, overseas office staff should understand the local culture and business organization of the assigned country. Where appropriately skilled host country personnel are not available, competent foreign nationals can be hired to support and train host country staff on the job in the overseas post. Promotion agencies should not seek to become professional advertising agencies, publishers, media consultants, and so forth, but rather rely on expert outside counsel as necessary for important program assistance.

5. Promotion program goals should be as specific as possible in order to increase the likelihood of effective design and execution.

While promotion activities ultimately are all intended to increase investment activity in order to meet national economic objectives, promotion programs themselves should be much more finely targeted, for example, to yield a specific number of investor inquiries from a given sector or country, or to generate a specific number of prospective investor reconnaissance visits to the host country. Such objective program goals should be tailored to the character of individual countries as sufficient investment promotion experience is gained. These targets will also need to be constantly adjusted as a function of changes in the domestic investment climate, the international business environment and changes in the effectiveness of the promotion programs themselves.

While investment promotion programs are more art form than science (as are all public relations/advocacy efforts), objective goal setting will establish standards for measuring the adequacy of the promotion effort and the relative costs and benefits of various activities. In addition, such standards could serve to insulate the promotion activity from unjustified political attacks by demonstrating the objective yield of resources allocated to investment promotion. Such standards could also help justify budget increases for promotion activities as more ambitious goals are set for achievement.

6. Initially, investment promotion activities should be characterized by modest programs and expectations.

Since promotion activities need to be tailored to the character and needs of the host country, with specific goals driven by program experience, it is logical that slow and deliberate program development is more likely to succeed than expensive, ambitious efforts. Furthermore, grandiose program designs and exotic promotion techniques often raise false expectations. Therefore, promotion activities are more likely to succeed if they are undertaken judiciously and grow incrementally, with experience as a guide.

7. <u>The promotion of indigenous investment should be a fundamental objective of investment promotion activities</u>.

Indigenous investment promotion--although often ignored by investment authorities--is essential to the ultimate success of all investment attraction efforts, foreign and domestic. Indigenous promotion efforts help develop a domestic constituency for private sector initiatives. The benefits of these promotion activities are easily demonstrable. Increases in local investment also creates a more conducive investment climate for foreign investment. Since the international competition for foreign investment is increasingly intense, promotion efforts aimed at indigenous investment might yield higher returns initially--especially in countries with objectively less attractive investment climates.

8. <u>Promotion agencies should develop and nurture domestic constituencies in support of private sector initiatives</u>.

Many of the same promotion techniques used to educate and entice investors should be employed in efforts to establish popular host country understanding and support for private enterprise. Domestic support networks will help marshall the political will needed to adopt sometimes controversial policies required to improve the business climate. Similarly, a constituency sympathetic and supportive of the private sector is itself an important positive inducement to prospective investors.

9. <u>Promotion programs should be tested, reviewed, and adjusted regularly as changes in the marketplace and the host country environment warrant</u>.

Targeting promotion activities and employing specific program goals should facilitate the regular review process required to improve program effectiveness on a continuous basis. In addition, before major new programs are initiated, pilot-testing will help by forecasting anticipated results.

10. <u>Investment promotion programs should be allowed sufficient time to work</u>.

Immediate or dramatic results from promotion activities are unlikely, and should not be expected. In fact, promotion programs aimed at quick results will often fail, since prospective investors--like all sophisticated customers--react adversely to hard sales pitches. Promotion programs take time to yield discernible results because they are essentially educational exercises. The more obscure the host country, or the more negative its image, the longer the lead time that will be required for programs to bear tangible fruit. This payout period can only be shortened marginally by substantially more ambitious programs and expenditures.

FOOTNOTES

1. Stephen Guisinger, project leader on IFC study, "Investment Incentives and Performance Requirements: A Comparative Analysis of Country Foreign Investment Strategies," telephone interview.

2. K. Billerbeck and Y. Yasugi, Private Direct Foreign Investment in Developing Countries, World Bank Staff Working Paper No. 348, July 1979, p. 3.

3. John A. Mathieson and John Sewell, "North-South Relations," Setting National Priorities: Agenda for the 1980s, The Brookings Institution, 1980, pp. 513-514.

4. K. Billerbeck and Y. Yasugi, op. cit., p. 13.

5. Isaiah Frank, Foreign Enterprise in Developing Countries, Committee for Economic Development, 1980, p. 42.

6. Organization for Economic Cooperation and Development, Investment Incentives and Disincentives and the International Investment Process, 1983, p. 41.

7. Robert I. Fleming, "Program for Accelerating Private Foreign Investment in the Less Developed Countries," Ford Foundation, reprinted in "Methods of Investment Promotion for Less Developed Countries," Agency for International Development, January 1967.

8. Robert Weigand, "International Investments: Weighing the Incentives," Harvard Business Review, July-August 1983, p. 146.

9. Stephen Guisinger, et. al., "Investment Incentives and Performance Requirements: A Comparative Analysis of Country Foreign Investment Strategies," International Finance Corporation, 1983.

Section Two

SELECTED COUNTRY EXPERIENCE

IRELAND

TAIWAN

JAMAICA

EGYPT

COSTA RICA

IRELAND

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IRELAND

I. INTRODUCTION: THE HISTORICAL PERSPECTIVE

Ireland has been dramatically transformed over the course of the last 25 years from a depressed essentially agricultural nation with a highly-protected, sluggish industrial base to one of the most profitable and fastest growing industrial centers in the European Economic Community. Ireland today attracts over 50 percent of all new American investments in the EEC and boasts one of the highest returns on investment in the world. Between 1977 and 1981 U.S. firms in Ireland registered an extraordinary 31.7 percent average rate of return on manufacturing investment--impressive if compared to the next highest EEC rate of return (Italy) of 18.2 percent, or Japan's 19.0 percent return on investment by U.S. firms.

An average of one new American plant opens each week in Ireland. American firms' capital commitments to the Irish Republic have mushroomed from $158 million in 1973 to $450 million in 1982, for a total commitment of approximately $4 billion. The Irish economy of 1983 stands in great contrast to the sleepy, undeveloped agricultural economy of just 25 years ago.

Economic histories of Ireland divide this country's development into a few distinct phases.[1] The 1920s were characterized by a period of relative free trade with the overwhelming economic emphasis on agricultural development. Industry only accounted for 13 percent of the workforce with most of the manufacturing employment in a few large textile and food processing firms. Over half of the country's employment was in the agricultural sector. The country entered a reconstruction period in the 1920s following its Civil War, but economic growth and the development of new jobs remained weak.

With the advent of the Great Depression and the abandonment of the gold standard (and the manipulation of currencies for competitive national advantage which followed), the Irish became determined to follow a more nationalistic economic policy. The government embarked upon an era of protectionism in an attempt to shelter Ireland from external economic competition. A wall of tariffs and quotas was built in order to help Ireland achieve self-sufficiency in basic industry and agriculture. These policies were reinforced by the so-called "economic war" with the United Kingdom in the 1930s. Indigenous manufacturing activity expanded to meet domestic needs allowing industrial employment to grow to 18 percent of the total labor force.

By the 1950s Ireland had wrung as much advantage out of its import substitution policy as possible. The quality and cost competitiveness of Irish goods had deteriorated in this protected environment, and industrial expansion or export promotion was impossible. The Irish Republic suffered growing unemployment, depressed standards of living and a significant rise in emigration. The country's balance of payments deficit nearly doubled between 1950 to 1951 to almost 15 percent of GNP. Severe measures which were taken to curb consumer demand and public expenditures brought the situation under control by 1957. However, one of the costs of these measures was that the country realized negative or zero GNP growth in the late Fifties.

Widespread disaffection with Irish economic performance under its protectionist policies led to the adoption in 1958 of the "First Programme for Economic Expansion." This document heralded the beginning of a new era of economic and social policy which saw the relaxation of restrictions on foreign-controlled industry and the introduction of tax incentives to expand industrial exports. The adoption of the Anglo-Irish Free Trade Agreement in 1965 speeded up this policy shift by dismantling the tariff barriers erected between the two countries. The new policies "put export-oriented expansion, even if under foreign ownership, before dependence on protected domestic enterprise."[2]

The results of these new economic policies were dramatic. During the 1960s the industrial sector grew dramatically with a 20 percent increase in industrial employment. GNP grew from 650 million in 1960 to 935 million in 1969 at constant prices--an annual growth rate exceeding 4 percent.

Manufacturing exports rose five-fold in value with an expansion of the market for Irish exports away from Britain and toward the United States, Canada and other EEC countries. This reversal in national economic objectives is symbolized by the substitution of the "Encouragement of External Investment" Act of the 1960s for the "Control of Manufacturers" Act of the 1930s. In 1969 the Industrial Development Act was adopted which provided a renewed and expanded mandate for the Industrial Development Authority (IDA), the engine of much of Ireland's recent economic success. Ireland's entry into the EEC in 1973 further catapulted Ireland into a new era of economic expansion and industrialization.

Quoting Dr. T. K. Whitaker, former Governor of Ireland's Central Bank and one of the architects of the country's economic transformation:

> A Rip van Winkle, emerging from a fifty years' sleep, would be amazed at how clean, well-clothed and nourished nearly everyone looks, at the new houses, buildings and roads, at the clutter of cars and buses on the streets, with no tram and hardly a bike to be seen, at the sophisticated gadgetry of our homes and offices.[3]

II. THE CURRENT STRUCTURE OF INVESTMENT PROMOTION

A. The Early Years

Ireland's aggressive industrial development policy had its legal genesis in the 1950s with the establishment of the Industrial Development Authority and other export promotion entities such as Coras Trachtala--the Irish Export Board. An industrial grants systems was initiated in 1952 with the creation of An Foras Tionscal, an agency empowered to offer grants to new or expanded enterprises covering up to 100 percent of the cost of land, buildings and training of workers in depressed regions of the country. These programs have been steadily expanded and restructured over the years, under the guidance of the principals articulated by the Minister for Industry and Commerce in 1950, Mr. Morrissey:

> The Government is certain that in the national interest the development of industry should not be left to follow a course set by the uncoordinated activities of individuals, companies and groups working to cater for market requirements as determined by themselves. There is still a wide field for further industrial activity, but it is one in which there is need at government level for assisting and supplementing the efforts of private enterprise, firstly by careful research and planning so that it may be determined by reference to national as well as to individual interests what precisely remains to be done and how and where it may best be done, and secondly, by taking the necessary steps, to ensure that developments regarded as necessary or desirable will be undertaken and carried out.[4]

A detailed chronology of the progressive improvement of industrial investment incentives is appended to this report. Suffice it to say for purposes of this analysis that the Government of Ireland in 1952 initiated a series of direct grant and tax incentive programs which have steadily expanded over the years to help the country achieve its goal of increasing industrial employment and real incomes.

These activities were raised to a new level of commitment and sophistication with the adoption in 1969 of the Industrial Development Act which provided an expanded mandate for the country's primary agency of investment promotion, the Industrial Development Authority. Specifically, the Act assigns IDA broad authorities for promoting industrial development. It was constituted as a parastatal organization reporting to the Minister for Industry and Energy. By statute IDA is "the" official body empowered to act under the Minister with "national responsibility for the furtherance of industrial development."[5] It is further authorized "to provide and administer such grants and other financial facilities for industry. . . ."; "to develop, construct, maintain and administer industrial estates and factory buildings . . ."; "to provide and arrange . . . housing for employees in industry"; and "to foster the national objective of regional industrial development."[6]

B. IDA Organizational Structure

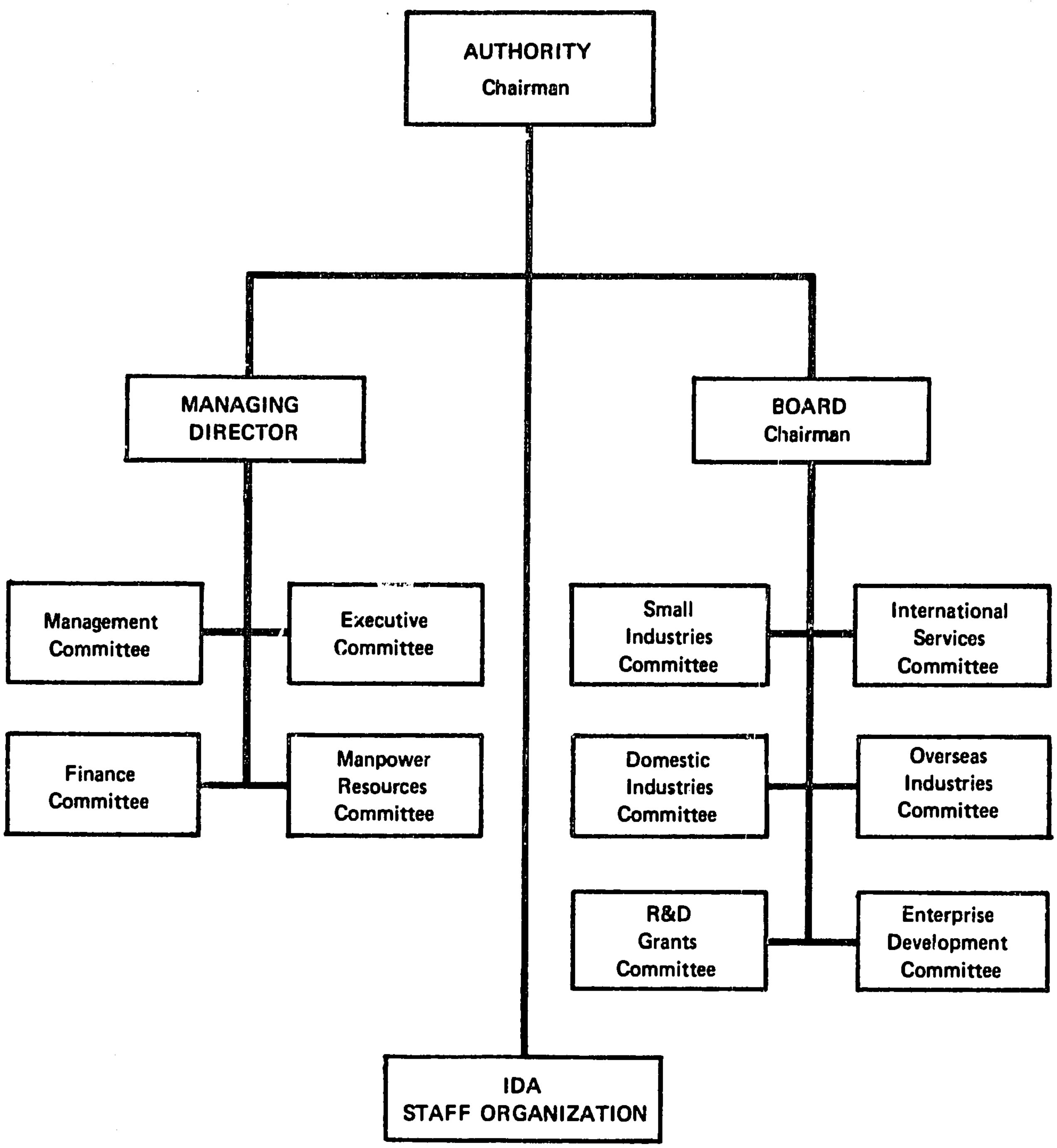
While IDA's funding is provided annually by the Government and it is ultimately responsible to the Minister of Industry and Energy, its organizational structure provides it an extraordinary degree of autonomy and independence.

Ultimate authority for IDA's actions is vested in the "Authority" which "formulates and reviews IDA policy and monitors progress under IDA programs." At present, the Authority consists of five private businessmen, one of whom is Chairman, an Assistant Secretary from the Department of Industry and Energy and the Managing Director.

More day-to-day program oversight of IDA activities is provided by its Board consisting of the Managing Director, his four chief deputies, one member of the Authority (currently the Assistant Secretary of the Department of Industry and Energy), and a Secretary to the Board. The Board meets weekly "to take decisions on individual grant applications other than those which have been delegated to the various IDA committees. . ." Herein lies a key to IDA's organizational success. These six committees are vested with considerable authority to give rapid approval to grant applications and other enticements to prospective investors, and they also coordinate and harmonize the views of various other government departments and interested industrial organizations represented on the Committees. A review of the purpose and membership of a few of these committees illustrates this fact.

Small Industries Committee

Purpose: To decide individual applications for grants under the Small Industries Programme. The Committee also coordinates the services provided to individual projects by IDA, Coras Trachtala, the Industrial Credit Company, and other agencies.



IDA COMMITTEE STRUCTURE

Members: (Chairman), IDA's Managing Director

Representatives of:

- Department of Finance
- Department of Industry and Energy
- Irish Productivity Centre
- Industrial Credit Company
- Coras Trachtala (Irish Export Board)
- Western Ireland County Managers
- Shannon Development
- IDA (2)
- Private Sector Member

<u>International Services Committee</u>

Purpose: To administer IDA's programs aimed at developing the international services sector.

Members: (Chairman), IDA's Executive Director

Representatives of:

- Department of Industry and Energy
- Coras Trachtala
- National Board for Science and Technology
- Academia (2)
- Banking Sector
- Private Sector
- IDA (2)

<u>Research and Development Committee</u>

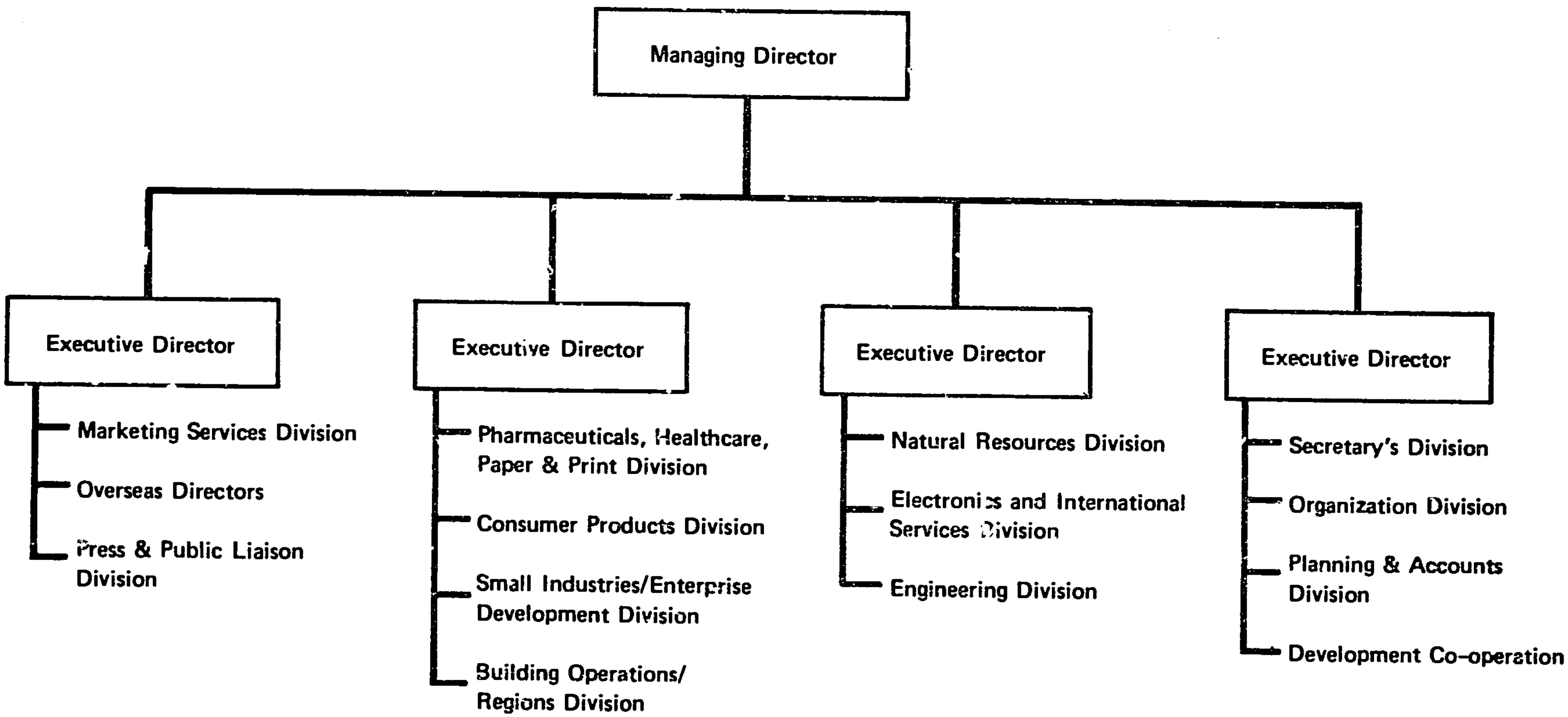
Purpose: To decide individual applications for IDA Product and Process Development grants.

Members: (Chairman), IDA Staff

Representatives of:

- Coras Trachtala
- Institute for Industrial Research and Standards
- National Board for Science and Technology
- IDA (2)
- An Foras Taluntais

The daily operations of IDA are entrusted to the Managing Director who has four deputies reporting to him with 14 operating groups and a total staff worldwide of 728. IDA's total number of staff positions has remained relatively static for the last five years. The following organization chart illustrates IDA's basic approach to investment promotion discussed later in this report.



IDA STAFF ORGANIZATION

In order to integrate IDA into all industrial development-related activities of the country, IDA devotes considerable staff resources to representation and participation in the activities of those groups--governmental and non-governmental--with an interest in industrial policy. The main boards, committees and organizations on which IDA is represented follows:

Boards, Committees and Organizations with IDA Representation

Board of Central Bank
Irish Management Institute (Chairman)
Institute of Public Administration (Vice President)
Council of Economic and Social Research Institute
Irish Council of European Movement (Vice President)
Board of Coras Trachtala
Council of Irish Management Institute
Sectoral Development Committee
Board of Shannon Development (SFADCO)
Board of Udaras na Gaeltachta
Executive Committee Shannon Development
C.E.E.P.-Irish Section and various committees

C.E.E.P. Brussels
Board of An Foras Forbartha
Central Development Committee
IDA/AnCO Training Grants Committee

Publicity Co-Ordination Committee
Furniture Task Force
Irish National Committee of the International Chamber of Commerce
Executive Committee of DEVSO-State
Agencies Development Co-Operation Organisation
International Symposium on Small Business
Irish Council for Overseas Students
Euro-Arab Dialogue
Japan/Ireland Economic Association
(Executive Director and Founder Member)
Ireland/Japan Economic Association
Ireland/France Economic Association
German/Irish Chamber of Commerce
Manpower Consultative Committee

Consultative Committee on Marketing
Sectoral Consultative Committee (Engineering)
Industrial Costs Monitoring Group
Interdepartmental Committee Studying Verolme Dockyard
An Foras Forbartha-Water Resources Advisory Committee
Construction Industry-Sectoral Development Study Group
Inter-Departmental Co-ordination Group-Building Industry
Management Committee Crafts Council of Ireland
Irish Offshore Services Association
Water Pollution Advisory Council
Innovation Centre NIHE Limerick
Micro Electronics Application Centre Limerick (Director)
Advisory Committee on Solar Energy (ACTM)
Chemical & Allied Products Training Study Committee
RDS-ASTRA Awards Scheme
Higher Education Authority
Sectoral Consultative Committee (Electronics)
Sectoral Consultative Committee (Beef)
Department of Agriculture-Four Year Agricultural Development Plan
Agribusiness Awards-Farmers Journal
Post Office Users Council
Sectoral Consultative Committee (Fisheries)
Irish Centre for Strategic Studies-Feasibility Study Management Centre
The National Quality Committee
Advisory Panel of the Fire Prevention Council
Construction Advisory Service, An Foras Forbartha
National Microelectronics Research Centre (Director)
HEA Computer Advisory Committee (Chairman)
Consultative Committee on Clothing and Textiles
Licensing Executives Society (L.E.S.) of Ireland
Joint Policy Committee on Small Industry-
IDA/SFADCO

Sectoral Consultative Committee (Chemicals and Pharmaceuticals)

Regional Development Organisations:
There are two IDA Representatives, one from Headquarters and one representing the region concerned, on each of the nine Regional Development Organisations.

County Development Teams:
The IDA Regional Manager is a member of the Team in each county of his Region.

IDA has nine regional offices in Ireland and 21 overseas offices. As the previous organization chart indicates, the overseas offices are overseen by regional directors for North America, Europe and the Far East. In the United States alone, IDA has nine offices, one each in New York;

Boston; Chicago; Cleveland; Los Angeles; Menlo Park, California; Houston; Fort Lauderdale; and Atlanta. IDA maintains ten European offices and one each in Tokyo and Sydney. The directors of these offices enjoy a great deal of autonomy and report directly to one of the four Executive Directors. Total IDA overseas staff numbers approximately 100 of a total IDA staff of 728. For the year ending December 1982, IDA listed administrative expenses of approximately $25 million. Of this amount, approximately one-half was expended on IDA's overseas activities. The majority of IDA's Ireland resources--budgetary and staff--are given to administering grant payments and other capital expenditures for purchase of industrial parks, factories and industrial land. Including all such expenditures, IDA's annual outlays are approximately $300 million. Funds and staff directly committed to promotion activities as narrowly defined later in this report represent a very small fraction of IDA's total annual budgetary commitments. By one IDA official's account, the organization has only 20 staff worldwide (3 percent of total staff) detailed to promotion activities.

C. Other Official Organizations

Ireland has two other industrial development agencies which work with IDA--the Shannon Free Airport Development Company (SFADCO) and Gaeltarra Eireann (a development agency geared to the needs of Gaelic-speaking areas of the country). The SFADCO was created in 1959 and empowered to make grants up to 50 percent of the cost of machinery and equipment to companies investing at Shannon airport. It also provides training grants and factories for lease at a new industrial park. The activities of this free trade zone authority were expanded in 1978 to encourage small indigenous industry in the midwest region of the country. SFADCO initially experimented with 47 pilot programs aimed at stimulating new companies or improving existing ones. Training programs were initiated to improve management skills for the small businesses targeted. Several advertising and promotion campaigns were undertaken to "stimulate respect for entrepreneurs and a desire to emulate them." Business advisory services are given at no charge to firms to assist in preparing their expansion plans, as well as in the areas of financial control, marketing, or production operations.

In order to facilitate business financing, special services have been developed by the Bank of Ireland and the Industrial Credit Company. In 1981 an Innovation Center was established at Limerick to offer various technical advisory services under one roof. In its first three years of operation, SFADCO's small industry pilot project has approved 345 projects representing 4,421 potential jobs and nearly $10 million in grants. The number of new jobs created represents a ten-fold increase over the previous three year period.

Udaras Na Gaeltachta was created (with the Gaeltarra Eireann name) in 1958 to promote economic and cultural development in the areas of the country where Gaelic is the first language. Gaeltarra Eireann was authorized to invest in and make grants to companies, and establish new industries, subject to the approval of the Minister for the Gaeltacht in consultation with the Minister for Industry.

Since the Gaeltacht areas are the most undeveloped and poor regions in the country, Gaetarra Eireann was given a mandate to promote agriculture, tourism, services, linguistic and cultural traditions as well as industry. Udaras has been forced to assume more direct ownership responsibility through equity shares because the fundamental infrastructure was so weak in its areas of jurisdiction that no investors would fund the necessary improvements. Accordingly, Udaras has invested approximately $35 million in 68 companies providing 1,800 jobs. Current plans are for Udaras to attract private companies more aggressively instead of extending existing direct investments.

D. Current Objectives

The Government of Ireland has undertaken a comprehensive review of its industrial policy, which is to culminate in a white paper report not yet released as of this writing. A study prepared for the National Economic and Social Council last year, however, may provide some indication as to the government's new industrial plan. This critique concluded that cash grant incentives offered to foreign companies located in Ireland were often needlessly generous, and that a greater share of resources should be allocated to indigenous instead of foreign businesses. A review of IDA's current plans suggests that this redirection of resources is already well underway.

The most current available statement of Irish industrial policy objectives is contained in the IDA Industrial Plan 1978-82. The fundamental objective of the plan--which propels all of the country's investment promotion efforts--is to increase new jobs in grant-aided industry by 40 percent. In order to meet IDA's goal of 15,000 new job creations per year, the organization has determined that industrial projects with long-term employment potential of 30,000 per year are required since only "some 60% of the expected jobs, on average, are translated into actual jobs in five years."[7]

The IDA arrived at its jobs targets in order to meet the goals established by the Government in consultation with IDA. The general jobs target was then further refined by IDA by stipulating its intention to help generate at least one-half of these new jobs in either new Irish-owned enterprises or through expansion of enterprises already established in Ireland. The plan further states that additional investments should be sought in state-owned companies; that Irish natural resources be more aggressively developed; and that special emphasis be placed on the encouragement of small indigenous firms.

Finally, IDA establishes the character of the industrial base it is attempting to develop by outlining the following characteristics of industry they are to encourage:[8]

-- industries, suited to the education and skills of our workforce employing graduates, craftsmen and technicians, make us less vulnerable to competition from low cost producers, e.g., electronic, electrical and mechanical engineering.

-- distinctive Irish quality products, e.g., fashion and craft-based products.

-- introducing and developing products with a high added value. In general this implies moving from production at the bottom end of markets, to products aimed at more expensive markets, characterized by good design and quality, finish and presentation.

-- developing natural resources, particularly in beef, dairying, timber, zinc, where market conditions justify investment.

From these objectives, established by IDA working in close consultation with the Government of Ireland, IDA then develops those programs which it believes are needed to achieve the targets.

Clearly one key to IDA's success in setting realistic objectives is its complete integration with those units of government responsible for industry. For example, in order to help IDA meet its ambitiously expanded job-creation targets, two decisions were taken by the government in 1978--the introduction of a maximum 10 percent corporate profits tax until the year 2000, and the decision to stabilize Ireland's currency by joining the European Monetary System. Furthermore, in order to avoid a serious mismatch between the skills of job seekers and those being sought by investors, IDA works closely with the Labour Ministry--through its membership on the Ministry's relevant Committees--to forecast skill needs and help train workers, particularly Irish youths, in these skills. In part, it is through such a process of national consensus building that IDA has been able to command the government resources needed to implement its programs.

III. INVESTMENT PROMOTION ACTIVITIES AND TECHNIQUES

A. Incentives

Ireland's investment climate is endowed with many important attractions which few countries can rival, supplemented by a rich program of financial incentives (one of which, as noted earlier in this report, has been criticized as unnecessarily generous).

First, Ireland has made a firm national commitment to private sector development. This commitment to private ownership is guaranteed by the country's constitution. Ireland's three political parties are all committed to the major industrial promotion strategies which the government and IDA are embarked upon. The Republic of Ireland also enjoys a stable political and business environment.

Second, Ireland offers one of the lowest wage scales in the Common Market ($5.76 per hour versus $7.26 for Britain and $11.78 for West Germany). In addition, the country features a highly literate, increasingly skilled, young labor force. For American investors, Ireland offers the added advantage of a native English-speaking population.

Finally, Ireland provides non-EEC companies with duty-free access to the 270 million consumers of the Common Market. It maintains excellent international transportation and communication links to Europe and the United States.

Added to these attributes, Ireland offers prospective investors a wide range of non-repayable cash grants toward the cost of fixed assets, including the capital costs of site and site development. These grants equal up to 60 percent of the costs of plant and equipment in undeveloped areas of the country, and a maximum of 45 percent elsewhere. Generally the grants amounts are based on plant location and numbers of workers to be employed.

IDA also provides investors with grants of up to 100 percent of the costs of employee training programs--including the costs of sending personnel abroad for training. The Irish Government's Training Authority (AnCo) also operates training programs to meet industry's specific needs.

Loan guarantees and interest subsidies are available for project financing, as are IDA-developed industrial sites to accommodate industry. IDA offers comprehensive advisory services on-site selection, factory construction, cost control, planning and plant pollution control requirements.

IDA offers up to 50 percent grant financing of new project feasibility studies, subject to a maximum of approximately $25,000 of eligible costs (including consultant fees). Eligible costs include market research, site/building plans, preparation of cost/financial projections and negotiations with a potential joint venture partner.

Grants are available for up to 50 percent (maximum of approximately $300,000) of the cost of researching and developing new products and manufacturing processes conducted either in-house or by consultants. Grants are also offered to help cover the costs of establishing permanent R&D facilities up to a limit of approximately $170,000.

Finally, prospective investors in Ireland are guaranteed a maximum corporate tax rate of 10 percent until the year 2000. The country's liberal depreciation allowances often reduce effective corporate taxation to zero.

IDA uses its incentive resources flexibly, stating that each investment's incentive package is tailored to the merits of the case. Incentives are not automatically offered to any firm--Irish or foreign. Rather, those firms which suitably meet the objective of job creation, and which advance viable projects are aided "to ensure that the best return is obtained on the expenditure of State resources."

Within the philosophy, IDA states that incentives will be used as follows:[9]

-- Entrepreneurs: there will be generous and flexible use of incentives for small industries and first-time entrepreneurs because of the national importance of fostering native enterprise.

-- New overseas firms: attractive and internationally competitive incentives will be offered.

-- Project characteristics meriting specially favourable incentives: subject to the basic test of commercial viability, the following factors will be taken into account in determining incentives in each case.

- location of project

- level of added value

- ability of project to provide jobs quickly

- skill content in jobs

- long term growth potential

- significance of the technology of projects in facilitating expansion of desirable sectors

- projects where R&D or marketing functions will be established in Ireland

- projects using native natural resources

- projects with spin-off possibilities to existing firms

-- Advance Factories: There will be continued heavy investment in advance factories with units from 3,000-77,000 sq. ft. In particular, factories for domestic small industries will be provided throughout the country to a much greater extent.

B. Promotional Literature

IDA regularly publishes numerous multi-color, attractive promotional pamphlets and brochures in five languages: English, French, German, Japanese and Italian. In 1982 alone IDA produced 32 promotional and informational brochures.

IDA's promotional literature reflects the organizations, highly targeted approach to investment attraction. Most of its literature is designed to appeal to a very specific group of prospective investors--for example, German electronic firms, American services sector companies, etc. All of IDA's promotional literature is written with great attention to proper usage of the target country's language and business expressions, employing credible factual sources. For example, an IDA brochure aimed at American investors advertises the country's high rate of return on investment for U.S. firms in Ireland, citing U.S. Department of Commerce statistics. In addition, most IDA literature highlights individual investor success stories.

Since attractiveness and credibility are two prerequisites for effective promotional literature, IDA has routinely relied heavily on outside professional counsel in the design and production of its publications. As a result, IDA's promotional literature is clearly the best produced worldwide. In addition, since most IDA literature is highly targeted, IDA's regional offices play central roles in the design and execution of literature aimed at their markets.

Finally, IDA literature is kept current. As facts change, IDA updates its literature to reflect new developments.

C. Advertisements/Media Campaigns

As in all other IDA promotional activities, advertising and media campaigns are technically and graphically first-rate, highly-targeted and with well-focused messages. Most advertising campaigns are aimed at changing certain negative perceptions prospective investors might have about Ireland's investment climate, or at creating a positive understanding of investment opportunities. For example, IDA recently began a media campaign aimed at persuading investors that Ireland has a workforce which is "educated, skilled and adaptable . . . ." This campaign was undertaken after IDA-sponsored survey data indicated that various high technology companies targeted for IDA investment attraction perceived Ireland to lack the requisite skilled workforce for successful high technology operations. The advertising campaign itself was developed to support IDA's strategy for the development of an Irish electronics industry.

In the last few year IDA advertising activity has been expanded in the United States and Europe. In the United States, selected television and inflight commercials were added to radio and business magazines for additional impact in eight targeted cities: New York, Boston, Los Angeles, San Francisco, Cleveland, Minneapolis/St. Paul, Chicago and Houston.

In Europe, advertising attention was given to certain industry sectors through the use of sectoral trade publications, supplemented the general business press. In addition, a specific campaign aimed at international services companies was run in Business Week, The Economist, and the Engineering News Record.

IDA increases the likelihood of successful advertising by relying upon local ad agencies in targeted countries, and by delegating authority for executing these campaigns to IDA's in-country staff. IDA currently spends approximately $2.3 million per year on advertising worldwide out of its current annual budget of approximately $25 million.

D. Press/Public Liaison

Press liaison within IDA focuses as much or more attention on domestic press development than on foreign press. Of the direct press contacts initiated by IDA, the press liaison office issues three to four press releases per week, highlighting new investment decisions, company expansions and other success stories. New project announcements are often made by public officials such as government ministers or members of parliament. However, such announcements are never made until an investment decision has actually been consummated lest they disturb what are oftentimes delicate negotiations. To protect prospective investors from an inquisitive press, IDA maintains careful control over discussions with a prospective investor by going to such lengths as registering the investor in a hotel without his company's identification. Prospective investors are also protected from overzealous politicians until an investment agreement is signed, at which time the announcement is usually made jointly by IDA and the new investor.

IDA's reasonably good reputation with the Irish media is based, in part, upon its use of trained, experienced journalists for press liaison activities. In addition, the press liaison office has access to all aspects of IDA's business and can respond to press inquiries quickly and with authority. The press liaison office also handles approximately 1,500-2,000 telephone inquiries per month from the public seeking information about various IDA-related activities. Speakers are provided from within IDA for community forums around the country. By undertaking such public/press liaison responsibilities, IDA seeks to inform the Irish public of the importance of the private sector to Irish development, and how IDA's budget is allocated in support of private sector development.

IDA's press liaison office also handles approximately ten telephone inquiries daily from the media. Foreign media calls are routinely referred to the overseas office for response if appropriate. The press liaison staff also encourage journalists to cover certain success stories.

IDA sponsors press tours for overseas press. However, such pre-arranged, prepaid tours usually do not appeal to U.S. journalists from well-established publications for fear that such tours might seem to jeopardize their objectivity. Nevertheless, in 1982 over 150 foreign journalists visited Ireland to review the country's educational, infrastructural and industrial progress. Over 100 were from Europe, 25 from the United States, 13 from Japan and six from other countries.

E. Seminars/Promotion Missions/Special Events

In its early days, IDA relied heavily on seminars to showcase the Irish investment climate in targeted overseas cities. These were usually hosted by large banks, accountant houses, or other credible third parties with activities in Ireland. IDA has been successful enough over the years that it can now usually forgo such intermediaries and convene its own meetings directly.

In 1982, six overseas visits were undertaken by government officials to promote investment in Ireland. These covered the United States, Britain, Germany, Scandinavia, the Netherlands and Belgium. In addition, IDA's chairman participated in two U.S. promotional tours. Generally such program ideas are developed by IDA's overseas office to fit into their overall promotion strategy. These missions usually include one or two Ministers and Members of Parliament, a senior IDA official and one or two overseas IDA staff members. In addition, prospective investors are always brought into contact with current investors in Ireland--usually from the parent company headquartered in a given overseas visitation site. Such seminars and promotional missions continue to play an important--albeit less critical--promotional function than in IDA's early years.

IDA's targeting of prospective investors has reached a level of sophistication that now includes the development of special events utilizing internationally renowned Irish talent to attract the attention of prospective investors.

For example, IDA has used the occasion of overseas tours by well-known Irish entertainers and athletes to link up such celebrities with targeted corporate executives who have an interest in classical music or sports. By arranging such meetings, IDA reasons that it gains a goodwill "foot-in-the door" for future follow-up. High-level dinners are also hosted by Ireland's overseas Ambassadors--primarly in Europe--to bring out prospective investors. IDA has even hosted a golf tournament promotion in Japan.

F. Field Offices

As indicated earlier in this report, of IDA's total personnel of approximately 700, 100 staff IDA's 21 overseas offices. IDA officials indicate that of IDA's total staff worldwide, only 20 are directly employed in the kind of activities IDA routinely defines as promotional--i.e., press liaison, advertising and audio-visual, literature development, promotion tours, etc. However, since IDA's overall activities are geared to industry-specific identification, recruitment, negotiation, approval and after-investment care, a substantially larger percentage of IDA's 700-person staff could be characterized as engaged in investment promotion broadly construed. In addition, IDA--at home and abroad--liberally supplements its staff by relying on in-country consultants, advertisement agencies, public relations firms, and so forth.

Of IDA's $25 million current budget, approximately one half is earmarked for its overseas activities. The overseas staff generally are recruited from IDA's home staff. These are individuals who know the IDA organization and how it operates, understand the Irish investment climate, incentives and difficulties and, above all, have private sector experience.

Each overseas office has its own budget based, in part, on the job creation targets assigned to that office for its attainment. The overseas office director also has authority to adjust staff salaries to make them commensurate with local salary structures and performance, thereby making an overseas post financially rewarding. As discussed later in this report, IDA assigns various job-creation targets to its staff which differ by country and sector, based on IDA's projections of what the investment marketplace might bear.

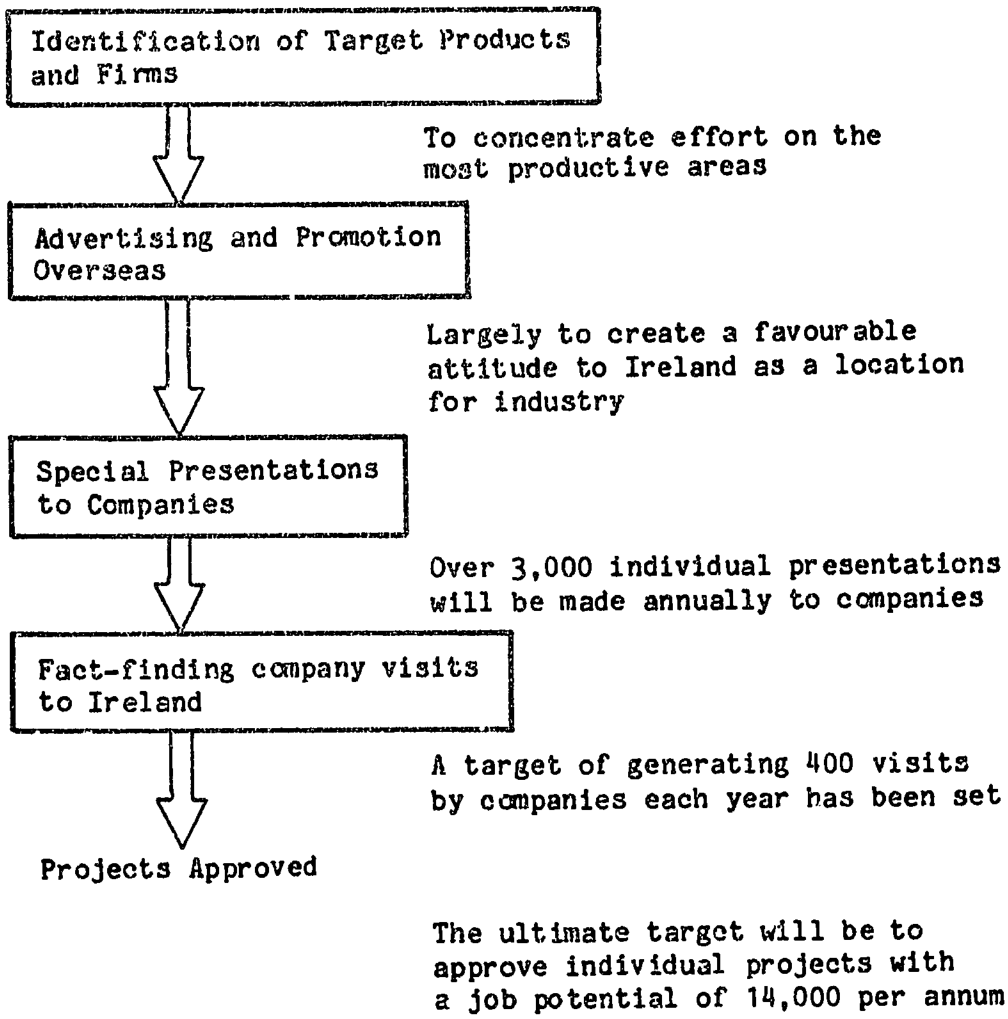
Overseas staff, in turn, report to the respective sectoral division in IDA Dublin to which they are assigned, such as consumer products, electronics, or pharmaceuticals. These individuals possess substantial authority to represent the organization and command support needed from Dublin. Overseas staff can speak knowledgeably with investors about the general investment climate as well as the specific conditions for a company in his or her given sector. In addition, overseas staff, with Dublin, arrange all the details of country fact-finding visitations for those investors who are still interested following the initial contact and subsequent special company presentation. Typically such presentations are made by IDA's overseas staff who visit a prospective investor at his office.

G. Promotion Planning/Targeting

IDA has over time developed a formula for projecting the number of firms which need to be identified and contacted in various ways before the long process of promoting investment yields and requisite number of investment approvals, jobs, or other goals. IDA's overseas office activities are to a large extent organized according to such a scheme.

IDA's current job creation objectives, developed in consultation with the relevant government ministries, was discussed earlier in this report. These new job targets propel all of IDA's investment promotion efforts.

With experience developed over time, IDA has been able to differentiate among their promotion activities, assigning annual quotas or targets on the level of effort required to meet their ultimate new jobs goal. Therefore, the IDA task as detailed in its last industrial plan can be schematized as below.



By constantly reviewing the impact of IDA programs in terms of their ultimate results, IDA not only can adjust or improve its programs, but also receive important feedback on the investment environment. For example, if historically only 3,000 special company presentations were required to yield 400 fact-finding visits by prospective investors, and more recent experience demonstrates that 6,000 such presentations are needed to yield the same number of visits, IDA has statistical evidence to suggest that either:

a) The quality of their promotional programs demands upgrading, or

b) The product IDA is selling--i.e., the Irish investment climate--needs to be improved, or

c) International economic conditions are not conducive to new investments, or

d) Some combination of all of the above.

This kind of objective performance feedback is a valuable tool for any successful investment activity since it helps prompt changes needed to maintain performance and public confidence in the investment promotion activity. Such changes which these objective indicators might help facilitate politically could include personnel changes, budget reallocations, or liberalized investment incentives.

Successful promotional activities often involve as much art as science. Nevertheless, the degree to which such programs can be assigned objective performance standards based on the need to meet national goals, can help determine the degree to which such programs will enjoy public support and be insulated from negative political pressures.

H. Development Cooperation

As part of the Irish Government's commitment to assist developing countries, IDA provides technical assistance on a consultant basis to developing countries through its Development Cooperation Program.

The program began in the mid-70s, is self-financed through fees paid by government clients and aid from the World Bank, the European Development Fund and UNIDO. The program consists of two main component parts: training courses conducted primarily in Ireland, and consultant assignments in developing countries.

In 1982, 85 participants from 11 countries attended nine IDA training courses in Ireland. Overseas training assignments were also undertaken in four African countries in that year. Training programs have been presented on such topics as project identification, project appraisal, small industry development, project management and industrial park management. In addition to these efforts, IDA employees were engaged in long-term overseas assignments in Lesotho, Malawi, Zimbabwe, Jamaica and Fiji. These activities cumulatively generated approximately $350,000 in contract revenue for the year 1982.

IV. INDIGENOUS INVESTMENT PROMOTION

IDA began formally promoting small indigenous industry with a pilot program in 1967 which was extended slowly over a ten-year period. In 1977, an IDA study indicated there was an inadequate understanding of IDA services among Irish industry. Therefore, beginning in 1979, IDA intensified its activities to encourage indigenous investments by increasing the budget and staff for its small industry programs. The last Industrial Plan (1978-82) stated the goal that over half of all new job approvals should come from domestic sources--primarily through expansion of established Irish and overseas industries, but also up to 20 percent of new jobs for the plan period from small industries (i.e., firms with less than 50 employees and with fixed assets at under $500,000).

The Small Industries/Enterprise Development Division has taken the lead in marketing IDA's services throughout Ireland with the same methods used overseas. All forms of marketing are being employed domestically--media campaigns, literature distribution, and special information clinics and seminars with local bank managers and universities to describe investment incentives available. Audio-visual presentations and speaking tours by IDA officials have been conducted throughout the country. In 1982, over 100 small industry clinics were held throughout the country; a conference was held for senior Irish executives on new product development; an Irish textile industry forum was convened to help solve sectoral problems; a series of presentations to secondary school pupils were held in conjunction with a newspaper campaign on careers in industry; and advertisements featuring successful Irish investors were run in local newspapers and on radio.

Recently an IDA "Walk-in Center" was established in Dublin to offer interested enterpreneurs ideas for new investments and IDA support. Since it opened in mid-1983, this center has averaged per week over 200 visitors, who are offered everything from simple literature on how to start a new business, to audiovisuals on marketing products, to detailed consultations with IDA staff on specific sectoral investment opportunities and needs.

IDA's indigenous investment activities appear to be paying dividends. Preliminary figures for 1983 indicate that as many new jobs will have been created in indigenous investment as in foreign industry. Whereas in 1967 IDA approved only 47 small industry applications, in 1983 IDA approved over 500 such applications. Small Industry Division staff estimate they spend three-quarters of their time advising prospective investors (including assistance with application preparation), and only a quarter of their time on the actual approval process.

A close look at the Dublin small industries program (where one-third of all Irish small industries are located) might better illustrate the IDA approach to small indigenous investment. In order to "inform" Dubliners of what IDA has to offer, the Small Industries Division (SID) convened a series of well-advertised meetings throughout Dublin. In addition, SID staff actually "walked the streets and lanes" of Dublin for three months to personally take the IDA message to existing Irish businesses. These activities were supplemented by the advertising and promotional programs highlighted above--including the Walk-in Center. Campus information centers were also established to generate innovative investment ideas. In essence, the first quarter of the year was spent primarily on promotion and advertising.

After each of these public forums, the IDA staff makes itself available for confidential discussions with interested parties. IDA's planning capability is here, again, a key to successful promotion. To avoid saturation of any given investment sector, a monitoring system has been established to identify over-supplied sectors and discourage new investments in these areas (by refusing IDA grants). For example, a prospective investor interested in opening a bakery would be denied IDA help because research has indicated that the market is saturated and static (and the investor would be so advised). Investments in natural resource-based industries for which there is an inadequate domestic supply are similarly discouraged.

Once a credible investment idea is identified, the prospective investor reviews his or her application for assistance with IDA staff. In fact, IDA staff often actually complete the investor's application based on their review of the product, its market and the business plan developed. Since capital financing was identified as a major barrier to new investments, IDA coaches investors on how to approach banks and work with accountants. In addition, IDA offers interest subsidies and loan guarantees, as well as equity investments in certain special cases.

Since most new investment ideas come from former employees, IDA has established an Enterprise Development Program (EDP) along with the SID. This program encourages first-time Irish entreprenuers with professional backgrounds (managers, engineers, etc.) to set up their own businesses. While SID caters mostly to blue collar skilled trades and production supervisors, the EDP seeks to capitalize on the skills developed by Irish managers and engineers trained in foreign firms. During its first five years of activity, 129 projects were approved, 85 of which were actually in operation by the end of 1982. The majority of the 224 entreprenuers involved in these projects were chief executives or directors of marketing or production. EDP experience indicates that new projects are often more likely to succeed if the new enterprise is "endowed" with financial, marketing and production skills. Since such skills are rarely found in one individual, EDP encourages the involvement of a few partners in new ventures.

IDA has also established a Project Identification Unit (PIU) to identify new manufacturing opportunities in Ireland primarily by examining the supply needs of foreign firms in Ireland. PIU also focuses on import substitution for the public and agricultural sectors. The PIU staff conducts research on local market needs and opportunities to replace imported projects. Such surveys are usually only three-to-four page reviews of product demand, local manufacturing feasibility, technology availability, and marketing scale required. These surveys are then made available to the public in all IDA offices. A few hundred surveys have been undertaken thus far by PIU.

If demand for a particular surveyed product is especially strong, PIU will, in conjunction with appropriate IDA staff from the product sector, identify potential investors. Once an investor begins discussions with the IDA sector staff, PIU's involvement ends. In PIU's first six years it identified 24 projects with a potential of 2,160 jobs, 60 percent of which were small firms. PIU efforts reportedly led indirectly to another 500 job approvals.

Finally, SID not only generates interest in indigenous investment opportunities via the promotion programs described above, but also takes the process the final two steps: formally evaluating and initiating the prospective investment project. In 1982, eligibility for the Feasibility Study Grants program discussed earlier in this report was extended to individuals and community groups as well as to companies. The number of these grants approved in 1982 (for a maximum of up to 50 percent of the study cost) grew to 273, with most study grants in the engineering and consumer products sectors. IDA estimates that 60 percent of these feasibility studies ultimately will convert into job creating projects. Feasibility grants can usually be offered with a minimum of red tape, since IDA Regional Managers can approve feasibility grants up to approximately $18,000, and up to $12,000 in Production and Process Development grants--whereby new products or industrial processes can be formally studied for feasibility.

To facilitate small industry investments, IDA has developed numerous industrial sites suitable for small businesses and craft industries. In addition, so-called "incubator units" have been undertaken which assist investors in initiating very small projects with expert guidance provided by various technical schools. IDA is also presently trial testing a computer model which helps prospective investors to proceed the stages of investment methodically with IDA staff. SID has also substantially increased its after-investment care for small firms to help them through the difficulties of the last recession. These activities include an Early Warning System to identify firms in trouble before they are beyond help.

In the final analysis, IDA has completely integrated indigenous and foreign investment promotion activities. However, since the needs and character of indigenous investments are often quite different from the typical foreign investment, IDA has created a series of programs specifically for Irish firms--primarily small-investors. These programs appear to be paying handsome dividends not only by equalling the number of new foreign company job creations annually, but also by generating domestic understanding and support for the IDA mission.

V. CONCLUSIONS

Clearly Ireland--IDA specifically--is the most sophisticated investment promoter examined by the project team. While many lessons from the Irish experiences have important applications to less developed countries, it would be inappropriate to assume that IDA could be replicated elsewhere. The IDA structure integrates functions more normally spread among numerous government and quasi-governmental bodies in other countries. Therefore, IDA is able to perform certain promotional and investment approval tasks with a degree of efficiency and dispatch generally inconceivable in most other countries. IDA clearly is a uniquely Irish institution developed out of an unusual confluence of historical events which made its formation and mandate somewhat fortuitous.

Nevertheless, even with its formidable political and public support and impressive record of success, IDA is being reappraised by the Irish government, obviously as a result of certain perceived disappointments and questions about its operations. A recent report prepared for the Irish National Economic and Social Council reviewing industrial policy raises questions regarding the gap between Ireland's industrial policy objectives and results.[10] This report also recommends reductions in financial incentives offered to foreign investors, and a reallocation of Irish resources towards indigenous industry. Similarly, the report is critical of the "mushrooming of staff assistance functions in many public agencies" made necessary by encouraging the establishment of firms too small to be viable. The report also warns of the dangers in delegating authority for the design of industrial strategy to a "development organization"--that is, IDA. To date, there has been ample evidence that IDA has either already addressed these problems, or is in the process of doing so.

For purposes of the SRI International assignment, however, a number of important lessons can be drawn from IDA's experience. These are incorporated in the framework section of this report. Briefly, the degree to which the various investment attraction and approval functions can be integrated enhances the degree to which investment promotion activities can be made effective. Other lessons to be drawn from the project team's IDA review relate to the overriding importance to be attached to the promotion of indigenous investment, the need for the establishment of clear and realistic promotion objectives, the absolute importance of staffing promotion offices with business-oriented professionals, and the critical need for promotion activities to be based on honest assessments of the country's investment climate.

FOOTNOTES

1. M. O'Donoglwe and B. J. Wiseman, Business Opportunities in the Irish Republic, Financial Times, London 1975.

2. Dr. T. K. Whitaker, "The Irish Economy Since the Treaty," Central Bank Review, 1976.

3. Ibid.

4. Mr. Morrissey, Ministry for Industry and Commerce, quoted in "A Review of Industrial Policy," Dublin 1982.

5. Industrial Development Act, 1969.

6. Ibid.

7. IDA, "IDA Industrial Development Plan 1978-1982," 1978.

8. Ibid.

9. Ibid.

10. Ibid.

APPENDIX A

CHRONOLOGY OF IRELAND'S INVESTMENT INCENTIVES*

Irish Grant Aids for Industrial Investment

- In 1956, the IDA was given the authority to grant aid up to 2/3 of the cost of industrial buildings and land anywhere in the country.

- In 1959, this IDA grant authority was turned over to An Foras Tionscal and increased by adding an allowance of 1/3 the cost of plant and machinery to be grant aided along with the 2/3 grants for land and buildings up to a total of 250,000 pounds.

- Also in 1959, SFADCO was created and empowered to make grants up to 50 percent of the cost of machinery and equipment to companies investing at Shannon airport. It also provided training grants and factories for lease at an industrial park it was creating.

- In 1963, the distinction between land and buildings and plant and machinery was abolished. Grants for capital investment as a whole in depressed regions were extended to 2/3 of total expenditures for projects under 250,000 pounds and 50 percent or 1,000 pounds per job (whichever was less) for larger projects. For non-depressed regions, grants up to 50 percent, or 2/3 in exceptional cases were allowed for smaller projects; for large projects the same rules held as for depressed regions. Labor training grants were also instituted universally.

- In 1965, Gaeltarra Eirann, which had been established in 1958 to promote employment in the Gaeltacht areas, was empowered to make grants and to buy shares in companies.

- In 1966, An Foras Tionscal was empowered to establish and administer industrial parks.

- In 1969, with the merger of IDA and An Foras Tionscal, the maximum grant limits were abolished and grant rates were reset at 40 percent for depressed regions and 25 percent for other areas, with an additional 20 percent possible in exceptional cases. At the same time, new industrial incentives were offered including grants for leased assets, interest rate subsidies, loan guarantees, and research and development grants of up to 50 percent or 15,000 pounds per project.

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* This chronology is adapted from "A Review of Industrial Policy," Dublin 1982.

- In 1970, standard grant rate guidelines were set at 50 percent or 5,000 pounds per job in depressed regions and 35 percent or 4,000 pounds per job in other areas except Dublin, which received 25 percent or 3,000 pounds per job.

- Beginning in the mid 1970s, the introduction of tax based leasing provided additional subsidies in the form of bank tax relief passed on to industrial companies for investments.

- In 1977, the IDA was permitted to supplement its normal financial support with assistance to working capital needs of projects by first time entrepreneurs.

- In 1978, research and development grants were increased to a 50,000 pound maximum.

- Also in 1978, section 84 of the tax code allowed banks to provide working capital financing to companies at low interest rates as a flow through of tax reductions accruing to them.

- Recently, additional grants not specifically tied to capital investment have been provided for several industries.

<u>Tax Incentives</u>

- In 1958, the tax remission on profits from incremental exports increased to 100 percent, and accelerated depreciation allowances on industrial plant and equipment were introduced. Also in that year, profits arising from export business at Shannon airport were exempted from tax until 1983.

- In 1960, the 100 percent tax remission on profits from increased exports was extended to 15 years with diminishing concessions for an additional 5 years.

- In 1967, free depreciation for plant and machinery in depressed regions was introduced with 50 percent initial allowances in other areas. A 20 percent allowance was instituted on buildings and land in all areas.

- In 1968, the initial allowance on plant and machinery was raised to 60 percent.

- In 1969, the export profits tax was extended to 1990.

- In 1971, free depreciation of plant and machinery was allowed in all areas of the country with an additional investment allowance of 20 percent for depressed regions.

- In 1975, the initial allowance applying to buildings and land was increased to 50 percent.

- In 1978, the export tax relief was replaced by a 10 percent across-the-board tax on all profits, which, when all the various allowances are considered, effectively means a negligible tax for most manufacturing projects in Ireland.

Trade Promotion

- In 1961, the Committee on Industrial Organization was established to review the structure of Irish industry in preparation for opening up the economy.

- In 1963, an "adaption grant" plan was established to help Irish firms adapt to the changed trade circumstances, with grants up to 25 percent of necessary expenditures. Also in 1963, Ireland instituted a 10 percent unilateral tariff cut.

- In 1964, another 10% unilateral tariff cut was instituted, and the law limiting foreign ownership of Irish industry was abolished.

- In 1965, the Anglo-Irish Free Trade Area Agreement was signed, providing for successive tariff cuts over 10 years in nearly all manufactured products until the tariffs were virtually eliminated.

- In 1969, adaptation grants were replaced by the re-equipment grants scheme, paying up to 25 percent (35 percent in depressed regions) of necessary investments for industrial modernization.

- Finally, in 1973 Ireland joined the EEC and free trade with other EEC countries was introduced in nearly all manufactured goods over a five-year period.

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I. INTRODUCTION: THE HISTORICAL HERITAGE

Over the course of the decade spanning from the mid-1940s to the early 1950s, Taiwan was subjected to a successive series of military, political and economic calamities which in combination ravaged Taiwan's productive capacity. From its low point in the early 1950s, when the island was considered -- with ample supporting evidence -- one of the true "basket cases" of the world economy, Taiwan has in three decades become a major economic power among developing countries. The causes behind this success are many and complicated, but a major contributing factor has been the continuous, careful nurturing of private sector investment and economic activity by the government.

A brief note on Taiwan's economic history helps to give a better understanding of the magnitude of this performance. Over the period 1895-1945, Taiwan was a colony of Japan. During this time, Taiwan was transformed from a traditional society and subsistence economy into a substantially modernized system in which the population enjoyed rising incomes from exports of sugar, rice, other agricultural commodities and natural resources to Japan. Japan's colonial rulers accomplished a great deal in terms of ending feudalistic practices, developing infrastructure and expanding agricultural output.[1]

Many of these positive economic accomplishments were unravelled by the course and aftermath of World War II. During the latter part of the War, Taiwan's industrial capacity was badly damaged by Allied bombing, which destroyed about one half of the nation's transportation, energy and industrial infrastructure. Under Japanese occupation, nearly all productive enterprises on Taiwan were owned and operated by the Japanese, who supplied managerial and technical personnel as well as investment capital. When Taiwan was retroceded to the Republic of China in 1945, all Japanese personnel were repatriated to Japan, leaving Taiwan's enterprises unmanaged and unfunded. In addition, Taiwan lost its favorable export relationship with Japan, since Japanese importers no longer felt any need to extend preferable marketing arrangements to Taiwan's agricultural producers.

The net result of these developments was a rapid decline in output in the immediate post-war years. In 1946, industrial and agricultural production dropped to one one-third and one-half, respectively, of that recorded during Taiwan's pre-war economic peak. Given the lack of private enterpreneurs to fill the vacuum created by the repatriation of the Japanese managers and technicians, the Chinese Government assumed control of the previously Japanese-owned companies.[2] In May, 1946, the numerous Japanese private enterprises were consolidated into 22 large public corporations owned solely by the central or provincial governments or jointly by both governments.

The next series of crises was caused by the deteriorating military and political situation on the China mainland in the late 1940s. The money supply was swollen enormously by speculative transactions, shortages in the supply of essential goods, and a huge inflow of liquid assets and gold held by incoming refugees from the mainland. Prices rose at a rate of 1,145 times a year in 1948.[3] In addition, local sources of food and consumer goods were strained by the increased demand caused by great inflows of refugees from the mainland. Between 1946 and 1955, the population of Taiwan increased by nearly fifty percent, from six million to nine million. Finally, with the fall of Shanghai on May 25, 1949, economic relations between the mainland and Taiwan came to a halt, and as a result the latter lost yet another protected market for its exports.

Given this economic backdrop, it is difficult to conceive how the economy of Taiwan developed so rapidly and consistently over the following three decades. In real terms, per capita GNP grew nearly sixfold between 1952 and 1982, at an average annual rate of six percent. The industrial transformation achieved in thirty years was equivalent to that which required at least a century in most industrialized countries. In the international sphere, Taiwan changed from being heavily dependent on external aid to representing a major competitive force in international markets.[4]

Before examining Taiwan's specific efforts to promote private sector investment, the basic characteristics of Taiwan's development strategy should be understood. While promotional activities per se have been considerable, the Taiwan government's approach has been focussed on creating an economic environment which is conducive to investment. While mistakes have been made, Taiwan's authorities have "done their homework" by taking those procedural steps necessary to accomplish this goal. They include the following:

1. Create a constantly improving, working knowledge of the economy's structure and components. Initially, the economy was relatively uncomplicated, but as commercial transactions became more sophisticated, Taiwan's policymakers created an exceptionally good system of statistical collection and analysis.

2. Develop a picture of the future. In 1953, the Taiwan Government adopted its first Four-Year Economic Development Plan, which has been followed subsequently by a regular series of plans of various durations. Within and outside of these formal plans, policymakers have developed forecasts of anticipated economic trends as well structural changes.

3. Develop a set of objectives. Through their development plans and other policy pronouncements, policymakers have established clearly stated objectives focussing on macroeconomic goals as well as on sectors to be encouraged or discouraged. These objectives, along with measures to achieve them, have been publicized widely so that private sector entities can adjust their activities and plans accordingly.

4. Adopt an overall strategy and substrategies aimed at attaining established goals. Taiwan is known for its "19-point programs," its "10-point programs," or its "4-point plans." These policy strategies are directed toward concrete objectives and generally represent real changes (permanent or temporary) in prevailing laws and regulations.

5. Retain flexibility. Some policies are effective in achieving their desired ends, and some are not. Taiwan's economic authorities demonstrate a willingness to acknowledge the need for change. This does not, however, imply radical shifts in basic commercial laws, which are anathema to the business community. In fact, most business officials suggest that the "evolutionary" policy process preferred by policymakers should be accelerated, albeit in the pro-business direction.

These factors represent the government's basic operational approach toward development efforts, especially in attempts to nurture Taiwan's basic comparative advantages and to overcome disadvantages. On the positive side, Taiwan has benefitted from an industrious and increasingly high-skilled labor force, a common external threat which has reinforced the maintenance of social order, and a widespread, commonly-held view that economic development is a high-priority national goal. In terms of disadvantages, Taiwan has had to cope with an almost total lack of natural resources (including oil), limited amounts of available land, and a deteriorating system of official relations with other countries. In a sense, these latter problems have been turned into advantages, insofar as they have forced local industries to increase their own competitiveness in order to overcome natural vulnerabilities to external forces.

II. TAIWAN'S PROMOTION STRATEGY

As noted previously, official efforts to encourage private sector investment in Taiwan have concentrated on policies which attempt to improve the investment climate, rather than on those activities which fit into the more narrow definition of "promotion." In fact, when asked initial questions concerning promotion efforts, almost all business executives interviewed in Taiwan responded by detailing their views on specific policies, such as foreign exchange controls, tax and trade provisions, and remittance allowances. One reason for such responses is the fact that many investors (both foreign and local) have been operating in Taiwan for some time, and hence do not encounter the promotional activities directed at new investors. The primary reason, however, is that, as in most countries, the business community views promotional activities (characterized as the bait designed to lure potential investors) as far less important than the actual operating and regulatory climate. Hence Taiwan's authorities have emphasized the latter.

Official efforts to improve the business climate have over the past three decades revolved around several strategic objectives, with relative emphasis among them changing over time. These goals include achieving and retaining economic stability, developing the potential productive capacity of broad economic sectors, improving the nation's basic physical infrastructure, and utilizing Taiwan's current and projected comparative strengths. The latter component includes the specific targeting of industries for special encouragement.

At the risk of oversimplification, one can conclude that primary emphasis in the 1950s was placed on achieving economic stability and on increasing agricultural production. During the 1960s, strategies concentrated on developing Taiwan's manufacturing sector, especially light industries oriented toward exports. These efforts were reinforced in the 1970s through the emphasis laid on the "Ten Major Construction Projects," aimed at improving Taiwan's infrastructure. Thus far in the 1980s, while government policymakers have concentrated on economic recovery from the worldwide recession, long-term strategies have focused on the ambitious goal of effecting a quantum leap in Taiwan's economic structure toward high technology and high value-added activities, in order to reduce dependence on labor and energy intensive production.

A. Early Efforts

Official government actions taken in the 1950s and early 1960s went a long way to establish the climate and ground rules for private enterprise in Taiwan. The earliest initial emphasis was placed on agricultural policies. In order to achieve economic recovery and enhance social stability, the government instituted a number of agricultural sector reforms. These began in 1949 when land rents were reduced. An extensive land reform program was implemented with the "Land-to-the-tiller" program initiated in 1953. Land reform attempted to redistribute income in favor of tenants or former tenant farmers. Agricultural holdings of traditional land-owning families were confiscated, and in compensation the families received land bonds payable in kind over time and shares of industrial corporations owned by the government. While the former landlords were not completely happy with this arrangement, according to a government official,

> This made it possible for landed capital to flow into industry, stimulated the interest of otherwise conservative landlords in industrial activities, and consequently expanded the scope of private enterprise.5

Agricultural development in Taiwan was given a major additional boost through the activities of the Joint Commission on Rural Reconstruction (JCRR). JCRR was established as a joint Chinese-American organization in 1948 and was mandated to program up to ten percent of the total U.S. economic aid extended to China. JCRR's activities extended to all major fields of agricultural development, including crop production, irrigation, animal husbandry, rural health and extension services. JCRR carefully avoided competing with local enterprises and sought to serve small farm ventures and farmers.

The second major accomplishment of the government over the course of the 1950s, which served to establish the basis for future private investment, was the restoration of economic stability and the implementation of foreign exchange reform. Chastened by the economic, social and political effects of hyperinflation, excessive government spending and currency instability, the government in the early and mid-1950s erected a formidable array of controls on prices. In addition, government spending was held to within strict limits -- a considerable feat given budgetary allocations for defense purposes.

Eventually the controls and restrictive policies began to take hold. Price inflation was brought into an acceptable range, the government budget was brought into closer balance, and confidence in the currency was restored. However, by the end of the 1950s, Taiwan's private sector was faced with an over-administered economy, particularly in terms of price controls, foreign exchange allocations, and multiple exchange rates. In addition, the inefficiencies associated with the government's import substitution policies became visibly apparent. Within this environment, merely conducting current business operations, much less carrying out longer term planning, proved excessively burdensome. The growing unwieldiness of these controls became clear to both the public and private sectors. As a result, the government undertook a series of sweeping reforms, beginning with foreign exchange reforms. The complex, multi-tiered exchange rate structure was dismantled, and exchange application procedures were simplified. To this day the government continues to control foreign exchange (that is, official approval must be secured for foreign exchange transactions), to the dissatisfaction of the private business sector. However, despite the burden of paperwork, exchange transactions associated with the conduct of normal business activities can be accomplished with relative ease.

B. The Inauguration of Investment Promotion

The year 1960 marked the genesis of Taiwan's official efforts to accelerate development through the encouragement of private investment. With the strong support of the U.S. aid mission, the Chinese government in February adopted its Nineteen-Point Financial and Economic Reform Program. This program addressed every major component of Taiwan's economic, fiscal, monetary and trade policies. Of special importance to future policy developments relating to the private sector were the decisions to improve the investment climate, liberalize administrative controls on industry and trade, and strengthen export promotion efforts.[6]

The second major development in 1960 was the adoption in September of the Statute for Encouragement of Investment, aimed at providing incentives to stimulate domestic and foreign investment. Other measures included simplification of investment procedures, trade and foreign exchange reform, rebates for customs duties on products used to manufacture exports, and the creation of credit facilities.

The final important step taken in 1960 was the creation of the Industrial Development and Investment Center (IDIC) within the jointly-run Council for U.S. Aid (CUSA). The role of IDIC was to examine all relevant factors bearing on private investment, such as factory registration, taxation, land acquisition, labor, banking, entry and exit formalities and many other government procedures and practices.

The IDIC has remained at the center of Taiwan's official investment promotion efforts since that time, although it has undergone a number of organizational changes. In 1963, IDIC was made a division of the successor to CUSA, the Council for International Economic Cooperation and Development (CIECD). When the CIECD was once again transformed in 1973 (into the Council for Economic Planning), IDIC was transferred to the Ministry of Economic Affairs (MOEA), where it has since remained. Despite these changes, the IDIC has been continuously charged with the responsibility of improving the investment climate and rendering various services to domestic and overseas investors.

III. THE CURRENT STRUCTURE FOR INVESTMENT PROMOTION

According to all sources of information, Taiwan's investment promotion system is dominated overwhelmingly by government bodies and activities, although private sector actors are tapped periodically to provide assistance. Overall, official groups design Taiwan's economic strategy, finance and operate promotional activities, and conduct all forms of relations with private sector organizations.

A. The Legal Foundation

The legal basis for all private enterprises operating in Taiwan is founded in a body of law covering incorporation, income taxes, customs, patents and trademarks, and labor practices. These laws, as well as those described below, are revised periodically as business climate opportunities and constraints evolve. Over time, gradual changes have tended to be in favor of private business interests, particularly in reducing government controls and regulations.

In addition to this legislation and the basic Company Law governing incorporation, investment in Taiwan is "promoted" by three important statutes:

1. Statute for Investment by Foreign Nationals (first enacted in 1954): This statute governs foreign investment in Taiwan by individuals and corporations other than Overseas Chinese. In substance the statute covers exchange settlements, repatriation of capital, and protection against expropriation. Under this framework, the only legal grounds for nationalization is national defense. To date, there have been no cases of nationalization. Twenty-year guarantees against nationalization are available for firms in which foreign investors hold equity of 45 percent or more. Firms with less than 45 percent foreign ownership are offered guarantees of reasonable compensation.

2. Statute for Investment by Overseas Chinese (first enacted in 1955): This statute is essentially the same as that described above, except that it relates to investments made by Chinese living outside Taiwan. Authorities make this distinction as a result of political and foreign relations considerations.

3. Statute for Encouragement of Investment (first enacted in 1960): Foreign and local firms which qualify for eligibility under this statute may negotiate a range of incentives. The major benefit is a five-year tax holiday with an optional four-year grace period before the holiday begins. Other incentives include accelerated depreciation and other tax benefits, exemption from import duties, and preferential land site arrangements. This statute guarantees equal treatment of foreign and local businesses. It also stipulates the right to obtain foreign exchange in order to remit profits, interest and other earnings, as well as the right to repatriate capital.

Eligibility for treatment under this statute is determined by the government, which maintains a list of qualifying industries and other business activities. This list changes over time, focussing on industries considered of particular value to the Taiwan economy. Primary emphasis has been placed on investments which increase exports, the flow of technology to Taiwan, the exploitation of natural resources, or which develop local infrastructure. The statute also includes incremental incentives for specially encouraged activities, such as relaxation of retained earnings provisions for "strategic" industries.

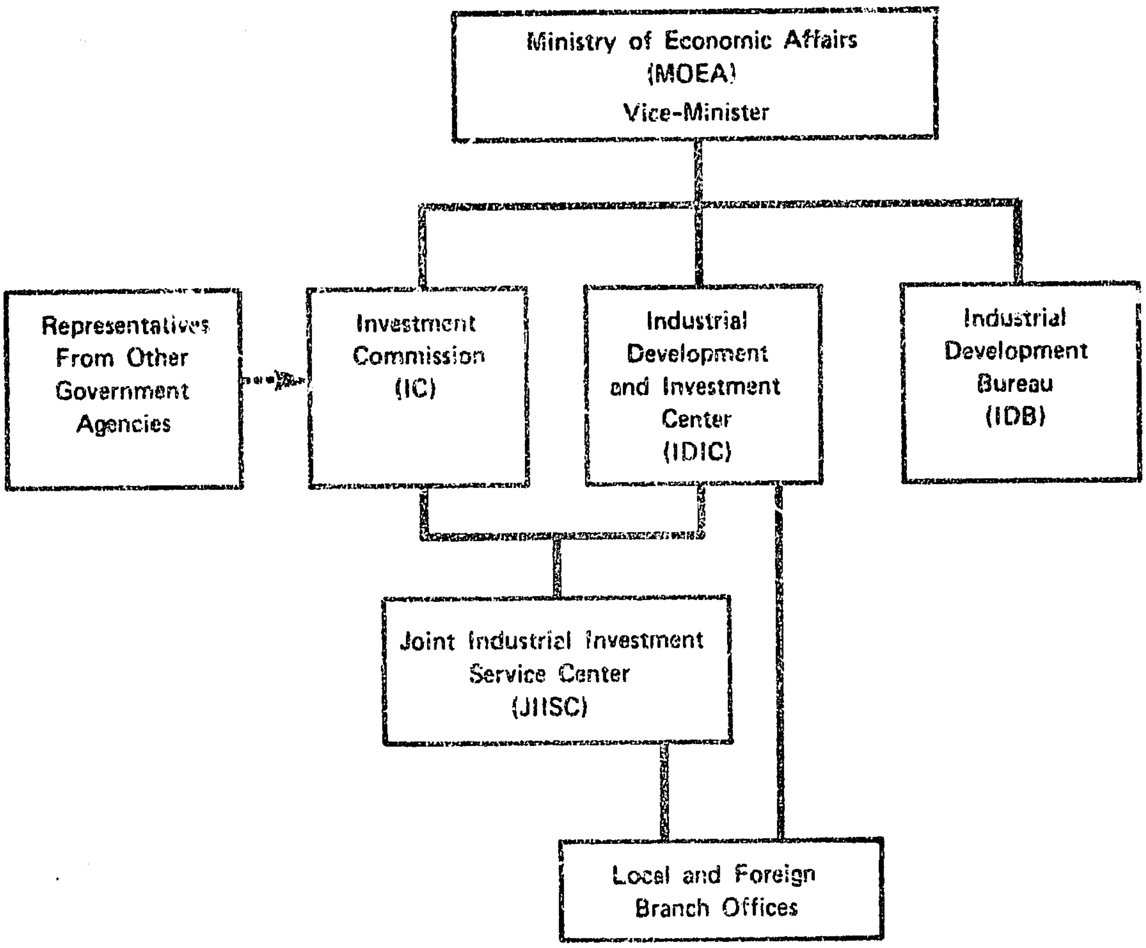
The government is currently in the process of altering the basic mix of industries eligible for incentives under this statute. In the past, a focus was placed on basic industries such as chemicals, aluminum, fertilizer, basic metals and plastics. The items which depend on "flame-based" or "electricity-based" production methods are gradually being phased out. In their stead, high-technology, high-value-added, and low-polluting industries such as peripheral computer equipment, information and communications systems and advanced machinery are now being sought. Through this and other policy mechanisms, the government seeks to direct the industrial development of Taiwan away from activities in which Taiwan is losing its international competitive edge, and toward industries which fit into Taiwan's long range economic plans.

B. Organizational Structure

Investment-related activities -- promotion, approval and regulation -- are all housed organizationally within the Ministry of Economic Affairs (MOEA), with all agency heads reporting to the same Vice-Minister of MOEA.

The major components of this structure are the following:

Industrial Development and Investment Center (IDIC): The IDIC has served as the locus of investment promotion activities for over two decades. It maintains active links between private investors and government agencies, and formulates proposals and coordinates government activities to encourage investment. The IDIC consists of a staff of 40 (including 7 representatives in four overseas offices), of which 25 are professionals and the remainder are support staff.



TAIWAN'S INVESTMENT PROMOTION STRUCTURE

The IDIC has four divisions. The Investment Promotion Division (professional staff of 5) introduces potential investors to the Taiwan business climate through advertising campaigns, seminars, and targeted corporate contacts. Recently, a large portion of these activities have been transferred to the JIISC, which is described below. The Information Division (staff of 5) participates in advertising campaigns, collects data, translates and publishes brochures, regulations and statistics, and prepares films and slide presentations on the business climate.

The Coordination Division of IDIC (staff of 6) carries out liaison work with other government agencies, supervises the 18 local chapters of IDIC (operated in Taiwan's counties and financed jointly by IDIC and the Provincial and local governments), assists investors with local problems such as plant site location and legal concerns, and provides investors with post-investment services. Finally, the Research Division (staff of 2) carries out special tasks such as overseeing externally-produced investment feasibility studies. At its inception, the IDIC consisted of two divisions, one each for promotion and research. The information and coordination divisions were added subsequently.

The budget supporting the combined efforts of the IDIC and the ten-person staff of the JIISC rose from $1 million in 1982 to $2.2 million in 1983. This rise reflects the full-year costs of the operations of JIISC, which were inaugurated in July, 1982, but also is evidence of increased government support for this set of activities, inasmuch as the overall government budget was reduced significantly over this period. Beyond these figures, it is difficult to arrive at a comprehensive estimate for Taiwan's investment promotion efforts, since many project and program costs are shared with other agencies such as the Government Information Office, the Board of Foreign Trade or the China External Trade Development Council.

Investment Commission (IC): The IC represents the governing body overseeing all foreign investment in Taiwan, including the approval of investment applications. Housed within the MOEA, the Investment Commission is staffed by representatives seconded from all government organizations concerned with investment. These include the IDIC and Industrial Development Board of MOEA, the Ministries of Finance and Interior, the Central Bank, the Taiwan Construction Department and the Board of Foreign Trade. The IC meets bi-weekly to render final judgements on investment applications. The time required for screening and approving applications is estimated to be about one month.

The IC maintains four in-house departments which carry out ongoing screening activities. These include the Foreign Exchange Department (staffed by representatives from the Central Bank), the Taxation Department (Ministry of Finance), the Export/Import Department (Board of Foreign Trade) and the Industrial and Commercial Department (Committee of Overseas Chinese). After these departments have granted their approval, the Foreign Investment Application (FIA) is then passed on to the JIISC, which works with the investor to obtain a final approval by the full Investment Commission.

<u>Joint Industrial Investment Service Center (JIISC)</u>: This group is in formal terms a joint venture of the IDIC and the IC, but in practical terms is a recent extension (as of July, 1982) of the services rendered by IDIC. Close cooperation between IDIC and JIISC is reinforced by the facts that both are located in the same building and that the Director of the JIISC also serves as Deputy Director of IDIC.

The ten-person staff of JIISC divides its time between two functions--investment promotion and investor service. With respect to the former, the JIISC coordinates overseas investment seminars, identifies and contacts potential investing firms, and carries out advertising programs.

In terms of investor assistance, the JIISC acts as a "one-stop service" for investors, coordinating investment related activities such as applications for investment approval, land purchases, tax and foreign exchange settlements, or problems associated with the establishment of factories. The staff also serves as trouble-shooter for investors with projects already in operation.

The JIISC was established with several objectives in mind. First, it was felt that other host countries such as Ireland and Singapore have more aggressively pursued foreign investment in sectors being actively encouraged in Taiwan, particularly in the high-technology area. While government officials believe Taiwan's overall infrastructure and operating climate to be superior, they felt that the investment incentive package offered is below that of major competitors. Therefore, a less passive and more active promotional effort is now considered necessary.

The second major reason for the creation of JIISC is the generally-held feeling that despite improvements, Taiwan's bureaucratic system of governing investments can be sufficiently burdensome to discourage potential investors. Therefore, the JIISC is designed to serve as an advocate for foreign investors, assisting the latter in dealing with regulations and other forms of "red tape." To serve its clients more effectively, the JIISC has recruited its core staff from the ranks of the business community.

Industrial Development Bureau (IDB): The IDB oversees the administration of all domestic industrial plans and policies, and with this broad mandate (comparable to the equivalent of large portions of the U.S. Department of Commerce, Federal Trade Commission, etc.) maintains a staff of over 200. Foreign direct investment constitutes only ten percent of total productive investment in Taiwan, hence leaving the vast majority of investment-related activities to the IDB.

In addition to administering investment laws and regulations relating to domestic investment, the IDB carries out a wide range of activities directly under its auspices or indirectly through its financial support. These include the activities of the Metals Industry Development Corporation (which provides technical advice) and the Small and Medium Business Association (a pseudo-governmental middleman between small businesses seeking credit and banks), as well as the development of satellite plants around large-scale industries such as steel and chemicals, in an effort to reap greater value-added. The IDB also coordinates a host of investment-related activities conducted under the auspices of MOEA, such as the Bureaus of Standards and Commodity Inspection & Quarantine, the Export Processing Zone Administration, the Medium and Small Business Administration, and the designation and development of new industrial districts.

While the IDB does not "promote" indigenous investment in the same sense that foreign investment is promoted, the IDB does render assistance in a variety of forms. One recent development is the establishment of four management consulting groups, one each for automation, energy conservation, export development, and new product development. These teams have visited some 700 local factories and have advised managers on production and management problems. While this program was applauded by all private sector officials interviewed, several noted that the teams uncover problems but do not provide sufficient solutions.

C. Other Official Organizations

The main government bodies responsible for conducting ongoing investment promotion efforts have been described above. Over time, a large number of additional government-operated or sponsored organizations have developed for the purpose of directing or assisting investment-related activities.

Council for Economic Planning and Development (CEPD): This council is the successor organization to the joint U.S.-Chinese aid agency active in the 1950s and early 1960s, before U.S. aid was phased out in 1965. A separate body reporting to the Executive Branch (Yuan), the CEPD serves to develop Taiwan's economic plans and development strategies. The CEPD must review and approve all changes in investment policies. Recently the Council was asked to prepare a study to revise all commercial and financial laws necessary to help Taiwan's economy adjust to a more advanced state of industrialization. Described as the government's in-house "think tank" on economic matters, the CEPD's basic orientation is to move toward free market forces and away from incentives and other forms of market interventions.

Industrial Estates: To facilitate the acquisition of land by investors for industrial purposes, the government has designated land at 121 sites throughout Taiwan as industrial land. These sites are all accessible to transportation links and are located in areas with available labor supplies. In addition, the government has developed 47 industrial parks with a total of 8,000 hectares of land. These parks have been provided with access to transportation, water and sewage systems, power, and other services.

Export Processing Zones (EPZs): Taiwan was a pioneer in the development of EPZs, establishing its first zone at Kaohsiung in 1966. Additional zones have been created in Taichung and Nantze, and a total of 272 export enterprises were operating as of the end of 1982 in the three zones. The Kaohsiung and Taichung zones are fully occupied. Potential investors in the EPZs are offered tax concessions, exemption from customs duties, simplified application procedures, preferential financing, and warehousing and transportation services. The zones have been instrumental in Taiwan's export push over the past decade, in which export firms utilized relatively low cost labor to produce consumer good exports.

Hsinchu Science-based Industrial Park (HSIP): This industrial park is the first developed in Asia exclusively for high technology industries. It is essentially an extension of the Export Processing Zones, and is oriented toward serving Taiwan's current objective of effecting a structural change toward high technology activities. The HSIP was established in 1980 in an area where a number of higher academic institutions of science and technology are located. Industries sought include electronics, computers, information systems, precision instruments and machinery, and high-technology materials. As of mid-1983, forty companies had requested permission to operate in HSIP, and twenty-six firms were fully operating. Approved firms receive a battery of incentives similar to those offered in the export processing zones.

Industrial Technology Research Institute (ITRI): ITRI is a semi-autonomous institute funded largely by the Ministry of Economic Affairs. It represents a merged organization comprising the Union Industrial

Research Laboratory, the Mining Research & Service Organization and the Electronics Industry Research Center. Located near the Hsinchu Science-based Industrial Park, ITRI carries out basic and applied research on projects such as robotics, and then offers the technology on a bid basis to local firms.

China Productivity Center: This center was established in 1955 under the joint sponsorship of the government and industry. Its objectives are to promote better management, supply industrial information and services, provide managerial and technological training, and generally raise the level of industrial productivity.

Bank of Communications (BOC): The BOC operates largely as a development bank, offering subsidized loans (currently at two percent below market rates) for "strategic" industries. From mid-year 1982 to mid-year 1983, the BOC invested some $18 million in twenty-six companies in an effort to attract and employ venture capital. The bank aims to increase this investment to a total of about $63 million by the end of 1985. These loans have been extended to metal processing, information systems, electronics, and transportation and chemicals firms. The bank raises funds on the international financial markets.

China External Trade Development Council (CETDC): Along with its associate organization, the Far East Trade Service, Inc., the CETDC is a non-profit organization supported jointly by government and business associations, and seeks to promote Taiwan's foreign trade. The CETDC carries out the entire range of trade promotion activities, such as publishing and distributing brochures, conducting seminars and trade missions, and developing trade opportunities. These organizations also maintain some 48 representative and liaison offices abroad, some of which are joint ventures with government organizations which promote investment in Taiwan.

IV. THE ROLE OF GOVERNMENT

The number, scope, and range of activities described above is indicative of the fact that the government plays an extremely active role in nearly every facet of investment-related activities in Taiwan. From the description of these wide-ranging set of organizations, one might conclude that the system of direct and indirect government intervention is highly differentiated. While this is increasingly true, the Chinese system of government is largely centralized, and so most decisions must be approved at the highest levels. The system is also based largely on a consensus model, and so many governmental organizations must be consulted and their active or tacit approval must be obtained before major actions are taken.

Business executive critics argue that this system combining compartmentalization and centralization inevitably leads to bureaucratic inertia, a point which is no doubt correct. The government has been particularly recalcitrant in its response to efforts to remove official controls over business transactions. However, over time the government has been responsive to the concerns and needs of the private sector. Taiwan's economic development and stability are viewed as critically and centrally important by government officials. Nearly all upper echelon leaders, including the President and the Premier, have at one time in their careers held posts related to business and economic affairs.

In broad terms, the government has shifted its emphasis from direct to indirect controls over economic activities. In 1953, publicly owned and managed enterprises accounted for as much as 57 percent of total industrial production. This share fell to less than 20 percent by the end of 1982. This shift has resulted from growth of the private sector rather than from major government divestitures. Certain strategic industries (e.g., military goods, petroleum refining, etc.) and public utilities are reserved for the state. State-owned enterprises (wholly or partially owned) remain in such industries as petrochemicals, mining and smelting, sugar, steel, shipbuilding and fertilizer. Most of these have been in existance for several decades. The explicit government policy is to refrain from establishing any additional government enterprises, and to open up existing state enterprises to private investors where possible. Currently, two state-owned entities, Taiwan Metal Mining Corporation and Taiwan Machinery Manufacturing Corporation, both of which are near bankruptcy, may soon be sold to private interests if buyers can be found.

Notwithstanding the continued existence of these state enterprises, governmental emphasis has shifted since 1960 toward efforts to foster private sector enterprises which are increasingly responsible for generating income, employment and foreign exchange. This swing has in turn led to the development of the existing body of law as well as the extensive organizational framework directed toward assisting private enterprises.

In terms of attitude, the government is strongly committed to private enterprise and to foreign investment, both for economic and political reasons. Despite its general hospitality toward foreign investment, the government does employ two approaches generally disliked by multinational firms. First is selectivity. The government clearly expresses its preferences for the kinds of investments being sought through formal policy and informal negotiation. This is most clearly demonstrated in the system of applications for corporate registration and eligibility for benefits included in the Statute for Encouragement of Investment. However, the ultimate outcome of investment applications is to a certain degree a function of the ingenuity of the applying firm. For example, the government does not encourage investments in fast food and consumer goods industries. However, McDonalds was granted an operating license on the grounds that it will establish a regional potato processing plant and will transfer technology on sanitary food processing. Similarly, Avon was admitted on the basis of its advanced product packaging capabilities.

The second approach disliked by potential investors is the increasing use of performance requirements. Local content requirements have been imposed since the early 1960s, with percentage shares varying according to the product being manufactured. More recent is the export-requirement for new foreign investment announced on August 1, 1983. The Minister of Economic Affairs decreed that, subject to negotiation, all new investments should export 50 percent of their production as part of their Foreign

Investment Agreement. This ratio was determined on the grounds that some 54.6 percent of Taiwan's GNP is in the form of exports. This requirement is determined on a case-by-case basis, and several firms have already succeeded in having it waived. However, the combination of local content and export requirements has been strongly attacked by the foreign investment community. Without arguing the merits of these requirements, they represent on a broader level the basic desire of the government to increase its control over foreign investment and to increase the local economic benefits generated by foreign firms.

V. INVESTMENT PROMOTION ACTIVITIES AND TECHNIQUES

Examining the investment promotion practices carried out by government bodies in Taiwan, one finds nothing mysterious or surprising. Basically all known promotional techniques have been or are currently being used. No secret formulas, strategies or emphases are apparent. The precise mix of activities has changed over time as a result of practical experience gained with respect to effectiveness as well as of changes in available promotional resources. However, promotional activities have been continuous and have expanded over time.

A. Brochures and Publications

Investors with an interest in Taiwan as a site of operations do not encounter any dearth of promotional literature. Brochures and other promotional literature are readily available in all shapes and sizes. The bulk of this material is produced by the IDIC (now in concert with the JIISC), and generally falls into one of three categories extending on a continuum between glossy packets and mundane literature. At one extreme, information brochures introducing investors, traders, or tourists to the general climate and virtues of doing business in Taiwan contain attractive photographs of cultural activities, scenic spots, and industrious work forces. In the center of the continuum, a number of brochures act as general guides for doing business in Taiwan, containing a more detailed discussion of prevailing conditions and business practices. At the other extreme, investor's guides are available and lay out in great detail information on legal statutes, current policies, labor practices, utility rates, investment categories encouraged and criteria for obtaining fiscal incentives. In addition to these publications aimed at general audiences, brochures covering such areas as export processing zones, the science-based industrial park, and trade opportunities are also prepared by their respective administrative organizations.

Overall, these publications are informative and are of high professional quality. They are updated on a periodic basis, and equally important, they are readily available. By design or by happenstance, they have the effect of first attracting the interest of potential investors and then gradually offering increasing doses of factual information. They present a highly positive picture, emphasizing Taiwan's economic successes and extolling the benefits of conducting business there. They devote very little attention to potential problems that an investor might encounter, although these problems are discussed freely in conversations with government officials. A list of publications obtained by the project team is provided in the bibliography.

Given the use of Chinese as the official language, the translation of documents is no small task. The quality of translations has improved markedly over the course of the past decade. The IDIC, which publishes English versions of new and revised laws, has recently adopted a cost-saving technique. A local private law firm translates certain documents and in return the law firm receives a free advertisement for its legal services.

B. Advertisements

The government has historically advertised heavily in foreign (especially U.S.) newspapers and periodicals, emphasizing Taiwan's political and economic stability and presenting the official government view on political and foreign policy issues. On the more narrow objective of investment promotion, advertising has been scaled down considerably due to budgetary constraints.

The usual outlets for mass media advertising have been Business Week, Fortune, the New York Times and the Wall Street Journal. Recently a more targeted audience was sought in an advertising supplement to the computer industry journal Byte, with costs shared by the government and corporate advertisers. This form of joint venture is expected to remain the model for the foreseeable future, although "shotgun" advertising is anticipated every two to three years. The "shotgun" approach is also utilized in the distribution of Taiwan Industry Panorama, a monthly publication on business climate developments.

C. Seminars

Taiwan's official investment promotion activities include a series of periodic seminars in major financial centers, primarily in the United States (two per year on average) but also in Japan, Europe and Hong Kong. These seminars have been described by officials as both a "shotgun" technique and a "fishing" approach, with the game in either case being potential investors. For example, in June, 1983, a series of six seminars in U.S. cities (Los Angeles, San Francisco, Dallas, New York, Boston, and Chicago) were conducted over a three week period using a revolving set of speakers. The seminars were organized by the IDIC's home and field offices (described below) and each lasted one day. Representatives from a total of about 500 corporations attended. Two formats were used. In the first, the showing of a film on the investment climate, formal presentations and question and answer periods lasted the full day. The second format eliminated the film and shortened the formal presentations, thus leaving the afternoon free for individual meetings. The general consensus is that the latter approach is preferred. Participants in the seminars included a high-level MOEA official (the Vice-Minister), representatives from IDIC and the science-based industrial park, and private sector officials from a law firm, an accounting house and a bank. The latter individuals paid their own way, and most of the seminars were hosted by large banks. These services are offered free of charge in return for the potential business they generate for their sponsors.

The intended strategy is to employ advertising campaigns and seminars to generate initial investor interest. Based on individual corporate responses, these would be followed-up by personal visits or smaller workshops (e.g., on food processing or on personal computers) involving a more select group of corporate prospects. Prior to official visits, investment promoters would conduct research on the operations and potential interests of prospects. According to current investment promoters, the experience is that on average the response rate to large seminars or targeted letters written to corporate officials is between 10-20 percent. That is, approximately ten to twenty percent of those firms participating in seminars or contacted by mail actively seek follow-up contacts and more information on Taiwan's business climate. They express a real rather than casual interest in pursuing opportunities further.

D. Direct Contacts

The IDIC and the JIISC have recently become more active in making direct contacts with potential investors by mail, telephone or personal visits. Most but not all of these contacts are made by staff members in the field offices. Historically the approach was more passive -- letters received from private firms were merely answered. Currently the field offices are spending more time researching possible candidates and pursuing leads more actively. The New York field office is in the process of computerizing its system for dealing with present and future candidates. It was noted that Taiwan officials also utilize the extensive informal network of overseas Chinese currently employed in high-technology industries for potential "client" contacts.

E. Field Offices

The IDIC currently maintains four branch offices overseas, one each in New York, Frankfurt, Hong Kong and Milan. The New York office is the largest, with an investment promotion staff of four. Each of the other branches has one investment promotion officer. The New York and Milan offices are joint ventures between IDIC and Taiwan's export promotion agencies. The Frankfurt and Hong Kong offices are used for investment promotion alone.

The government's strategy for utilizing its foreign representation offices efficiently is to employ an active referral approach. Overseas embassies, consulates or offices of representation (in view of Taiwan's unique set of foreign relations) maintain supplies of brochures and basic information for potential investors, who are quickly referred to regional investment promotion offices. These centers provide more detailed information and counselling, and then pass on leads to the home offices of IDIC, the JIISC, the export processing zone administrations, or the science-based industrial park, depending on the nature of the firm and its interests.

It is worth noting that while official bodies do provide a wide range of services to potential investors, these services are limited to the distribution of information and the facilitation of interactions with government agencies. The government does not extend financial assistance for company executives to travel to Taiwan, nor does it conduct pre-investment feasibility studies for individual firms. These activities are considered the responsibility of the investors themselves, and should reflect their actual commitment to carrying through new ventures. In addition, government officials feel that sophisticated investors deem officially produced feasibility studies as inadequate, and would seek to avoid government knowledge of proprietary company information. Various government agencies have, however, periodically produced or contracted sectoral studies which are made available to all prospective investors.

F. Investment Incentives

As noted above, the Taiwan government provides a standard package of investment incentives for investments which qualify under the Statute for Encouragement of Investment or take place in the export processing zones or science-based industrial park. The primary incentive offered is an income tax holiday for encouraged investment. Internal government studies indicate that this provision results in a loss of some 20 percent in government tax revenues from eligible firms. This cost, however, is offset by income and employment generation; eligible firms account for some 10 percent of the total labor force in Taiwan.

In addition to the standard package of fiscal incentives, the government has from time to time enacted special measures to encourage investment, particularly as a counter-cyclical policy. Currently, investment tax credits are available to all firms (10 percent for imported equipment and 15 percent for locally purchased equipment). These and other special provisions such as subsidized interest rates for local investors are temporary and will be removed as business conditions improve.

VI. PRIVATE SECTOR ACTIVITIES

As noted above, the overwhelming majority of investment promotion efforts are conducted directly by government entities. However, as the Taiwan economy has grown in size and depth, an increasing number of private sector groups have become more involved in promotional activities and in developments affecting the business climate.

As a result of complaints from private corporations on governmental procedures for managing investment, the government hired a private body, the Taiwan Economic Research Institute, to conduct a comprehensive audit of these rules and regulations. The Institute carried out an extensive fact finding project, including a detailed opinion survey of private firms. The study covered nearly every aspect of the business regulatory environment, such as investment registration, auditing and financing procedures, export inspection, labor relations, and so forth, and in a twenty chapter report generated several hundred recommendations. According to private and public sector officials, some 40 percent of the suggestions were adopted immediately, 30 percent are currently under study for eventual adoption, and the final 30 percent were deemed as "worthy of more careful examination." Periodic reviews on the progress made in the implementation of these recommendations are anticipated.

The Taiwan Economic Research Institute was recently asked by the government to conduct a major ($1.3 million) research project aimed at identifying specific investment opportunities which correspond closely to basic changes in Taiwan's comparative advantage. Also involved in the project are the Chung Hwa Research Institute (which will examine macroeconomic developments), and Dae Hwa Research Institute (Japan) and Arthur D. Little (U.S.), which will provide inputs on international economic developments. The Taiwan Economic Research Institute will focus on the establishment of a list of "strategic" industries with high market or growth potential. Key variables sought are industries which are energy saving, low polluting, have a high value-added coefficient, require high levels of skilled-labor and technology inputs, and have a high "linkage effect" (spillover benefits to other sectors). Once this list of some 100 industries is determined, the government would then theoretically develop a special set of incentives to promote investment in those categories.

These and related research undertakings are of interest in several respects. First, while the government possesses considerable research capacity, it has consciously tapped private organizations to examine both existing practices and future potential opportunities. Also, by funding these activities, the government is seeking to expand the capabilities of indigenous, private research organizations. In the past, the government relied heavily on international consulting organizations. Finally, the latter study in particular is indicative of Taiwan's approach to industrial planning. This strategy involves the determination of a set of "desirable" business activities (in concert with private sector advice) and then the development of a set of incentives to encourage the growth of those activities.

A number of private sector associations are active in their efforts to improve Taiwan's business climate and international economic relations. Of particular importance are those involving U.S. business interests. The <u>USA-ROC Economic Council</u> is a large body (340 members) which fosters increased business interactions between the United States and Taiwan, primarily through annual business conferences and close contacts with policymakers in both countries. The <u>American Chamber of Commerce</u> conducts an active policy dialogue with Taiwan officials, focussing primarily on the concerns of the U.S. business community. Current topics high on the agenda include improved access to the Taiwan market, controls on profit remittances for service sector firms, rules relating to the protection of intellectual property (patents and trademarks) and investment performance requirements.

Local business interests are represented by a number of organizations, particularly the Chinese National Association of Industry and Commerce and the General Chamber of Commerce of the ROC. These groups meet formally with government officials, but their influence is felt primarily through the personal contacts of their leading members, who include most of Taiwan's principal industrialists.

Business-government interactions are fairly extensive. High level government officials meet periodically with the foreign business community (about twice each year) and local business officials (monthly). Opinions vary on the utility of these sessions, although the tendency is for local business leaders to be more favorably disposed than their foreign counterparts as to the perceived receptivity of the government officials and the level of the dialogue.

On one critically important point -- access to government officials -- there was universal consensus. The accessibility of even the highest level policymakers to business executives is considered excellent. While entrepreneurs may not receive what they want in terms of government decisions, they do have sufficient opportunities to make their positions known.

VII. DIFFERENTIATION BETWEEN FOREIGN AND LOCAL INVESTMENT

According to all officials and executives interviewed, the policy framework in Taiwan does not discriminate between foreign and local entrepreneurs. This assertion is in large part valid, with several exceptions. Foreign and domestic firms are on the whole subject to the same body of laws, incentives and regulations. Foreign companies do benefit from the privilege of a 20 percent limit on dividend withholding taxes, whereas local companies are subject to a progressive income tax. Taiwan's indigenous firms, on the other hand, benefit from tariff protection (although they claim they do not) and from the selectivity applied to foreign investment applications. Foreign companies are proscribed, either explicitly or implicitly, from initiating ventures in a number of sectors, primarily service industries such as financial services and transportation. Foreign manufacturers cannot repatriate profits from service center activities (i.e., repair and maintenance), although larger manufacturers provide such services in order to retain customer satisfaction.

Within a narrow definition of the term, investment promotion (advertising, seminars, etc.) is oriented almost exclusively toward encouraging foreign direct investment in Taiwan. The historical emphasis on foreign firms has been a result of perceived shortages of domestic investment capital. More recently, Taiwan's desire to increase the presence of foreign corporations has stemmed from political and strategic goals, as well as from economic motivations.

For local investors, fiscal incentives, government directives and access to government assistance serve as the primary promotional tools. Within Taiwan, capital formation and the development of firms with economies of scale have been hampered by strong socio-economic factors. Historically, the Chinese have been loath to place their considerable personal savings into publicly visible accounts and investments. There is also a strong preference among Chinese entrepreneurs to operate their own enterprises (usually within a family context) rather than work within a larger corporate structure. As a result, the indigenous business sector is highly fragmented. Within Taipei City, for example, a city of approximately two million people, there exist some 500,000 registered enterprises and 50,000 import-export firms. While many of these companies are undoubtedly inactive, the figure aptly reflects the fact that vertical mobility within firms is limited and hence qualified staff often leave their employers to start their own small firms. One example offered to support this assertion is the fact that while the size of the Taiwan market is sufficient to support perhaps five efficient pulp and paper mills, there are currently 165 mills in operation.

The natural result of a fragmented private sector with an extraordinary number of small firms is the dilution of management expertise and the evolution of business practices of relatively poor quality. The government has undertaken considerable efforts to overcome these problems, by attempting to raise accounting standards, encouraging local Chinese to invest, and offering assistance to improve management practices. To date these efforts have yielded limited success, given the extent of the task.

VIII. ASSESSMENT AND CONCLUSIONS

The extraordinary developmental success of Taiwan is well documented. An industrial transformation has been engineered, and living standards and economic output have been raised steadily at rates well above international standards. The rate of savings as a share of GNP has risen from 9 percent in 1952 to as much as 31 percent in 1982. The share of capital formation as a percentage of gross domestic product increased from 15 percent in 1952 to 25 percent in 1982.

Foreign investment in Taiwan, which represents only 10 percent of total capital investment, has also expanded rapidly. Between 1952 and mid-1983, a total of 3,048 foreign investments have been approved, involving some $3.7 billion in capital inflows (these figures are somewhat higher than actual investments made). About one half of these cases (and one third of the total capital) represent investments by overseas Chinese. Of the remainder, the bulk of the investments in terms of capital came from the United States ($1.1 billion) and Japan ($0.8 billion), followed by European and other investors.

In terms of the ultimate objective of encouraging private sector investment, therefore, one must conclude that Taiwan has met with considerable success. However, the vast majority of these investments have been made as a result of opportunities generated by improvements in

Taiwan's overall economic and business climate, rather than due to government promotion efforts.

While official government bodies have been very active in encouraging private investment since 1960, their primary emphasis has been on improving Taiwan's competitive standing through the development of economic infrastructure, the utilization of labor resources and pro-private sector changes in the regulatory environment. In all these efforts, the role of the government has been considerable. In a marketing sense, one can conclude that in terms of selling Taiwan as a base for investment, the government has focused on product development rather than on product promotion.

In recent years, government-operated programs to promote indigenous and foreign investment have expanded, primarily as a function of the depressed international investment climate and increased competition from other countries. This trend will continue, particularly as the strategy to develop Taiwan as a base for high-technology industrial activities evolves.

FOOTNOTES

1. Ching-Yuan Lin, Industrialization in Taiwan, 1946-72: Trade and Import-Substitution Policies for Developing Countries, (Praeger, 1973), pp. 13-27. (Hereafter cited as Industrialization in Taiwan).

2. K.T. Li, The Experience of Dynamic Economic Growth On Taiwan, (Mei Ya Publications, 1976), pp. 360-361. (Hereafter cited as Dynamic Economic Growth on Taiwan).

3. Industrialization in Taiwan, p. 31.

4. A discussion on the causal factors behind the success of the advanced developing countries can be found in John A. Mathieson, The Advanced Developing Countries: Emerging Actors in the World Economy, (Overseas Development Council, Development Paper 28, 1979).

5. Dynamic Economic Growth on Taiwan, p. 44.

6. Industrialization in Taiwan, p. 83.

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JAMAICA

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I. INTRODUCTION: THE HISTORICAL HERITAGE

Most assessments of Jamaica's economic and business climate begin with the statement that given its rich natural resource base, agricultural potential, a climate highly conducive to tourism, and a small but highly diversified economy, Jamaica possesses most of the basic ingredients required for rapid economic growth and development. However, Jamaica's actual performance has fallen far short of its potential. The primary reason for this gap is straightforward -- the government organizational and policy framework which in theory should serve as a stimulant to economic activities has in the case of Jamaica acted as a deterrent to long range development efforts, particularly those carried out by the private sector.

The political and economic factors which collectively shape the investment climate of Jamaica can best be characterized as a pendulum moving toward or against private sector activities, with each swing lasting as long as a decade. From the mid-1950s through the 1960s, the Jamaican development "model" concentrated on the exploitation of large bauxite reserves, the expansion of tourism, a continuation of plantation-based agricultural activities, and the encouragement of manufacturing through an import-substitution industrial policy. Both prior to and following Jamaican independence in 1962, these efforts proved relatively successful and generated real economic growth rates exceeding four percent on average.

As in many developing countries, this forward momentum was reversed by the series of international economic shocks experienced in the 1970s. In the case of Jamaica, these adverse external developments were unfortunately reinforced by a number of policy measures adopted by the government of the People's National Party (PNP) elected in 1972 and headed by Michael Manley. Faced with a highly unequal distribution of income and severe social tensions, the Manley government was elected with a mandate to effect a "transformation of Jamaican society," employing a development strategy which steered between the apparently extreme models of capitalism and central planning.[1] Without dwelling on the merits of this approach, it did lead to policy decisions which exacerbated the effect of external factors beyond the control of the government.

The PNP government's rhetoric was backed up strongly by its actions. A number of new laws were passed in an effort to engineer a redistribution of economic and social equity, in areas such as access to education and health facilities, minimum wages, severance pay and maternity leave. An ambitious public housing program sought to provide low-cost housing to the poor and to maintain low prices through rent controls. Following the implementation of the less than successful jobs program, the government expanded public enterprises to create more employment.

The PNP government also gained ownership and/or control of several important economic sectors. Following the lead of OPEC, the government implemented a 1974 levy on bauxite companies which raised bauxite revenues sixfold and nationalized 51 percent of the major bauxite companies. The government purchased utilities, banks, foreign-owned sugar plantations and mills, nearly half the large hotels, and a significant number of manufacturing concerns. The sum result was that while government revenues and expenditures came to account for approximately one quarter of Jamaica's GNP, it is generally estimated that the "public sector" directly or indirectly controls up to one half of Jamaica's total output of goods and services.

Nearly every basic economic sector in Jamaica, each one oriented toward international transactions, suffered a decline in activity in the 1970s. The precipitous oil price rises of 1973-1974 and 1979 reduced tourism receipts and crippled the burgeoning small manufacturing sector. Tourism was further affected by adverse publicity on Jamaica's rising crime rates. Exports of bauxite and its processed derivative, alumina, were diminished by a combination of worldwide recession and the high bauxite levy. Both foreign and domestic investment came to a virtual halt as a result of general declines in economic activity, and due to the anti-private enterprise rhetoric voiced and actions taken by the government. Added to these economic trends were rapidly rising government budget deficits; government payrolls and programs were maintained to support incomes and employment in a period of falling domestic output.

The ultimate outcome of these developments was a long-term deterioration of economic activity. Negative growth rates were recorded in every year from 1973 to 1980. Real per capital income declined by more than 25 percent over this period. By 1980, unemployment had grown to over 30 percent, and annual inflation reached a rate of nearly 30 percent. In terms of its international accounts, Jamaica's declining current account performance and borrowing-financed budget deficits led to a huge buildup of accumulated foreign debt.

The aggregation of these harsh economic realities translated into an untenable political position for the PNP government, which was replaced by the Jamaica Labour Party (JLP), headed by Edward Seaga, in October, 1980. Upon assumption of power, the JLP government immediately began to implement a program designed to generate economic recovery and once again to reorient the developmental path of the Jamaican economy.

The current government's economic strategy involves four basic components: the use of foreign assistance and other capital inflows as "bridge finance" to support Jamaica's structural adjustment, a reduction in the size and scope of the government, a shift from import-substitution to export-promotion policies, and a revitalization of private sector business activities.

On the first plank, the Jamaican government negotiated a $700 million credit arrangement with the IMF in 1981 for balance of payments support, and obtained foreign assistance from a wide range of multilateral and bilateral donors, including some $180 million per year from the United States. In order to reduce the size of government, and in line with IMF conditions, a freeze on public hiring was enacted, public sector access to credit was limited, and a divestiture committee was formed to manage the sale or restructuring of more than sixty publicly-owned commercial enterprises. Trade and foreign exchange controls were altered to reduce the protection enjoyed by domestic firms and to encourage exports. Finally, a number of steps have been taken to increase the role and health of the private sector, particularly through deregulation and the removal of price controls.

The initial results of these measures were positive and created a state of euphoria within the Jamaican private sector. The long term slide in GNP was reversed, with modestly positive growth rates recorded in 1981 and 1982. Local investor's attitudes were buoyed by public pronouncements and the inflow of large numbers of foreign investors investigating business opportunities.

The momentum gained in 1981 and 1982 faltered in 1983. Growth indicators fell off and highly publicized investments did not come to fruition. Unemployment rates remained high. Earlier positive growth rates were attributed primarily to aid inflows rather than to new domestic economic activities. The government was forced to reverse previous decisions on deregulation and price decontrol. The Jamaican private sector, while still supporting the JLP government initiatives, remained skeptical as to whether the difficult policy choices could be made and implemented.

In short, one can conclude that the Seaga government has attempted to engineer a highly difficult and complex reorientation of the Jamaican economy, shifting the center of control and activity from the public to the private sector. Impressive results were achieved during the standard "honeymoon" period enjoyed by the JLP government. However, the program led to unrealistically high expectations, particularly in view of the depressed international investment climate and the magnitude of changes required in Jamaica. Left unfulfilled, these expectations have in turn led to frustrations in the private sector and a growing consensus among public officials that further steps are necessary if long term recovery is to be achieved.

II. CONSTRAINTS TO PRIVATE INVESTMENT

In order to appreciate the large number of steps taken by the Jamaican government to promote private sector investment, an understanding of the scope of magnitude of constraints to investment is necessary. Jamaica has not been considered as having an environment conducive to investment by either domestic or foreign firms, and there is a high degree of unanimity on the fundamental nature of the problem.[2]

A. The Bureaucracy

The basic problem inhibiting private investment lies in the hands of the government itself, in terms of excessive bureaucracy, the complexity of regulatory requirements, and a general anti-private sector bias within "the system." Responsibility for the development and implementation of policies affecting private investment is widely shared.

> This plethora of agencies sometimes with split or shared responsibilities poses great difficulty for the businessman. There is widespread agreement within both the Government and the private sector that the multiplicity of organizations causes confusion not only for foreign investors and that it is inefficient in the use of scarce professional manpower and is inhibiting to the consistent and speedy implementation of policies.3

This assessment comes not from any private sector group, but rather from the Jamaican government in its terms of reference for a study of the government's institutional framework affecting industrial activity.

The problem of excessive bureaucracy is deep-seated, particularly for a country the size of Jamaica, with a population of approximately 2.3 million. The total size of the public sector is not even known, either in terms of government agencies or total employment. Jamaica has witnessed a rapid growth of parastatal organizations over the past few decades, a development which commenced even before independence. The number of government organizational units, classified as either "general government" or "public enterprises" is estimated at anywhere between 1,500 to 2,000. A recent World Bank report cites some 966 separate "general government" agencies and 227 "public enterprises."[4] Admittedly, a large number of these organizations are inoperative. But even allowing for a wide margin of error in these estimates, the number involved can easily be deemed as excessive, particularly for a country with a population comparable to a medium-sized U.S. city such as metropolitan Baltimore. As one Jamaican private sector executive quipped, "When you in America perceive a problem, you throw money at it. We in Jamaica create a new organization, and no existing bodies are ever dissolved."

The natural result of Jamaica's large and decentralized bureaucracy, in which many agencies possess highly discretionary powers, is confusion and frustration on the part of the business community. A recent study team identified forty-two departments and statutory authorities, overseen by eight ministries, as having operational authority for the government's shorter-term industrial and agribusiness strategy.

> Throughout its study, the team was impressed by the strikingly unanimous consensus it encountered in every corner and at every level as to what was termed the excessive size of, and the extent of redundancy in, Jamaica's public sector machinery.[5]

The public sector has grown persistently over decades, including the creation of a "second government structure" of statutory authorities in addition to functional line ministries.

The practical impact of this structure on business activity has not been lost to current and more importantly prospective investors. The U.S. Business Committee on Jamaica recently conducted a major survey of investors' attitudes toward Jamaica.[6] The survey sample includes firms which have recently examined Jamaica for investment opportunities. When asked what were the major obstacles encountered by those pursuing or still considering a venture, the principal constraint cited was government procedures. For those obstacles rated as important or very important, the time required to obtain approvals (75 percent of responses) ranked highest, followed by the number of bureaucratic approvals required (70 percent), import procedures (56 percent) and obtaining foreign exchange (56 percent). In a separate question, respondents cited government procedures as the major bottleneck to project implementation.

B. Shortage of Foreign Exchange

Before new investments of any magnitude can be expected, Jamaica's chronic shortage of foreign exchange will first have to be overcome. For economies such as Jamaica, which are strongly dependent on imports of raw materials and components, protracted exchange shortages soon begin to drive the system itself. Obtaining exchange allocations and import licenses--through legal or less than legal means--preoccupy the business community.

In the case of Jamaica, problems associated with acquiring foreign exchange to finance imports and repatriate profits rank high on the private sector's expressed list of obstacles to investment. Local business executives claim that all the positive steps initially taken by the current government have been more than offset by the growth of restrictions on trade and exchange. As noted by one executive, if they want their firms to stay in business, even conservative, highly ethical managements are forced to become "thieves" under the current circumstances, obtaining foreign currency through false invoicing, illegal transfer pricing and other means. Similarly, it was noted that in nearly all meetings involving private sector groups, the discussions tend to deteriorate into debates on how to overcome exchange constraints.

C. Inefficiencies From Import Substitution Policies

The Jamaican private sector benefitted in the short run but suffered in the long run from an extensive battery of import substitution policies. Firms geared toward manufacturing or assembling products for local consumption were for years provided with high levels of protection against competing imports. A study conducted for the World Bank and covering the late 1970s concluded that the manufacturing sector in Jamaica "benefitted" from nominal protection of about 35 percent and "effective" protection (a more accurate indicator) of as much as 70 percent.[7] That is, domestically-produced products of comparable quality to imports could remain price competitive even if they cost 70 percent more to produce locally.

In recent years, import substitution industries have also benefitted at the expense of export-oriented firms from Jamaica's overvalued exchange rate. These and other price distortions have had the effect of eroding the ability of Jamaican industry to compete in international markets. Production and management inefficiencies were offset by the policy-induced price advantages, hence providing little incentive for the adoption of cost-containing measures.

The Jamaican government has fully acknowledged the structural problem which has developed, and has taken a number of steps to effect "structural adjustment." Most important was the establishment of a "parallel exchange rate" which removed some of the anti-export bias, followed by the formal devaluation of the Jamaican dollar from U.S. $1.78 to about U.S. $3.15 in December, 1983. Initial efforts have also been made to liberalize Jamaica's restrictive import regime. However, the full impact of Jamaica's basic lack of competitiveness and consequent foreign exchange shortages has yet to be felt, and will cause increasing economic and social pressures in the near future.

D. Legal and Regulatory Constraints

As a direct result of the structures and policies noted above, domestic and foreign entrepreneurs face rules and regulations described in multi-mixed metaphors as "an endless maze of rules involving a crazy quilt of laws administered by an alphabet soup of agencies." Import licensing and customs procedures are cited most often as being unnecessarily complex, but major changes have also been suggested for the regulatory environment relating to land use, foreign exchange acquisition, labor relations, access to public utilities, and rules concerning the remittance of profits and dividends.

A major problem cited by private sector executives is the large degree of discretionary power exercised at nearly all levels of all government agencies. Given the number of approvals required from different government bodies for even relatively non-complex business transactions, final approvals can be delayed almost indefinitely without the personal intervention of high-ranking officials, including more often than not the Prime Minister.

E. Infrastructure and Human Resources

One set of constraints often cited by prospective investors relates to Jamaica's "comparative advantage" vis a vis other potential investment sites. First, lack of access to sufficient and reliable sources of electricity and water has been a problem for those firms requiring steady inputs. Recent improvements have been made in this area.

Human resource constraints are a function of two factors. First, Jamaica lost a large number (between 20,000-30,000) of its more educated managerial and professional work force through emmigration over the course of the 1970s, hence creating a shortage of qualified middle-level personnel. Second, Jamaica has gained a reputation for labor unrest, with work stoppages hindering normal production schedules. This has effectively hindered attempts to encourage investment in labor-intensive forms of manufacturing.

F. Attitudes

A serious problem inhibiting private sector investment stems from attitudes held by both the government personnel and the business community. Given Jamaica's colonial history and highly bureaucratic tradition, government officials remain suspicious of the activities of private businesses. Jamaican society continues to blame the private sector in large part for the inequities, real or perceived, in the Jamaican economic system. Therefore, major policy initiatives which are seen as providing incentives or subsidies for the business community are viewed as reverting back to "the old ways."

The private sector itself harbors certain attitudinal problems. Protected by long-standing import substitution policies, local business executives remain ambivalent about the shift toward a more open economy oriented toward exports. Business leaders readily admit a lack of self confidence in dealing with "the forces of international competition." Even those fully committed to this strategy harbor serious doubts as to the government's ability to develop and implement fully the necessary changes in policies and programs.

III. THE CURRENT STRUCTURE FOR INVESTMENT PROMOTION

For a country or economy the size of Jamaica, to conclude that the existing legal and organizational structure affecting business activities is complex would be a gross understatement. Prospective investors must contend with a large number of rules, regulations and government bodies before any new venture comes to fruition. Ironically, the structure which was created largely for the purpose of promoting different forms of investment has in fact become a deterrent to new investment.

The basic problem in the government's approach for dealing with the private sector is the tendency, deeply ingrained in the Jamaican tradition, to create new laws or organizations to address new issues, rather than utilize existing rules and institutions. Efforts to consolidate these structures have been and are being made, but face considerable opposition from existing government bodies.

A. The Legal Framework

The basic law governing incorporation and the conduct of business in Jamaica is the Companies Act, which came into effect in 1967. Utilized by the vast majority of private firms operating in Jamaica, including foreign investors, this law provides rules for incorporation, registration, management and administration, and dissolution.[8]

For companies which do not seek investment incentives, the approval process is relatively simple. While the Ministry of Industry and Commerce and the Bank of Jamaica screen all foreign investment proposals, approval is given by the Bank of Jamaica to permit firms to repatriate capital and profits.

Most investors do, however, seek incentives to offset what they consider the "disincentives" inherent in doing business in Jamaica. These firms are faced with a dizzying array of incentive laws and administrative bodies. One promotional brochure lists separately incentives provided by twelve separate government agencies:[9] the Ministries of Industry and Commerce, Finance and Planning, Tourism, Mining and Energy, Public Utilities, Agriculture, and Labour and Public Service, and the Jamaica Industrial Development Corporation, the Jamaica National Export Corporation, the Jamaica Export Trading Company, the Jamaica Marketing Company and the Bank of Jamaica.

Investment is covered by some fifteen separate legislative acts. Most of these laws date back to the 1950s or 1960s. Primary among these is the Industrial Incentives Act enacted initially in 1956 and amended on several occasions. This law provides eligible firms with a fiscal incentives package including exemption from income tax payments from five to nine years, depending on local value added; exemption from customs duties on raw materials and machinery; and exemption from taxes on dividends. This law, along with its counterpart, the Export Industry Encouragement Law, is administered by the Ministry of Industry and Commerce. Applicants for incentives present to the Ministry a set of documentation covering the proposed venture's contribution in terms of foreign exchange earnings, employment, productive capacity and transfer of technology. The number and degree of incentives provided are in effect determined by the level of contributions projected.

Investors interested in other sectors must deal with other laws and authorities. Tourism ventures are managed by the Ministry of Tourism under the Hotel Incentives Act (1968) and Resort Cottages Incentives (1971). Shipping companies deal with the Shipping Incentives Act (1979) administered by the Ministry of Public Utilities, which also oversees the activities in the Kingston Export Free Zone under the Kingston Free Zone Act (1980). Extraction companies must go to the Ministry of Mining and Energy, and agribusiness concerns to the Ministry of Agriculture, utilizing the Agricultural Incentives Act.

In addition to securing basic approval for their ventures, firms must also obtain a number of permits associated with import licenses and foreign exchange acquisition, performance bonds, work permits for non-resident personnel, land or factory space acquisition, access to power and water supplies, and so forth. The time and efforts required to obtain these approvals is considered highly excessive by prospective investors. In short, the legal structure and its accompanying management is conducive to inter-agency disputes which translate into frustrating delays for potential investors.

B. The Organizational Structure

As noted above, a wide array of government agencies involve themselves in various ways in the approval, regulation and promotion of private sector investment. The line ministries administer the basic laws and incentives related to business activities. In addition, final approval for investment incentives is determined by the Joint Ministerial Committee on Investment Incentives, chaired by the Prime Minister. This committee meets once per month to reach decisions on investment applications.

Activities related to investment assistance and promotion are not generally carried out by the ministries, but rather by a large number of statutory authorities, most of which are connected organizationally with one of the ministries. In practical terms, however, most of these authorities -- listed below -- operate on a relatively independent basis.

Office of the Prime Minister

- Jamaica National Investment Promotion, Ltd. (JNIP)

Ministry of Industry and Commerce

- Jamaica Industrial Development Corporation (JIDC)
- National Industrial Development Corporation (NIDCO)
- Jamaica Commodity Trading Corporation (JCTC)
- Trade Board

- Agricultural Marketing Corporation (AMC)
- Bureau of Standards

Ministry of Finance and Planning

- Jamaica National Investment Corporation (JNIC)
- Agricultural Credit Bank (ACB)
- National Development Bank (NDB)
- Jamaica Export Credit Insurance Corporation (JECIC)
- Project Analysis and Monitoring Company (PAMCO)

Ministry of Foreign Affairs and Foreign Trade

- Jamaica National Export Corporation (JNEC)
- Jamaica Export Trading Company (JETCO)

Ministry of Public Utilities and Transportation

- Kingston Export Free Zone (KEFZ)

Most of these authorities are organized in a similar fashion. Boards of directors include representation from the public and private sector. Day-to-day operations are left largely to managing directors, who report both to their boards and to their statutorily designated ministry. In most cases, the authorities stand alone as complete organizational units, each with its own operational unit, research group and administrative machinery. Given the nature of competitiveness among the authorities, each generally prefers to develop in-house capabilities rather than share facilities and operations with counterpart groups. One reason cited for this organizational insularity is that the individual authorities act as a base of power for their upper management within the Jamaican government structure. This factor apparently outweighs the generally unifying force of interlocking directorships, a common practice in Jamaica.

A brief historical note is instructive in explaining the evolution of this maze of organizations. According to officials knowledgeable of Jamaican economic history, Jamaica's development and investment strategy in the 1950's and 1960s was largely "passive," with economic activities managed largely by foreign firms and large landholders. The only official organization which conducted an active development program was the Jamaica Industrial Development Corporation (JIDC), established in 1952 and given sweeping powers" . . . to stimulate, facilitate and undertake the development of industry. . ."

By the late 1960s, a consensus emerged that Jamaica's private sector-dominated development had run its course. As a result, the government began to assume greater control over the economy. At that time, a number of organizations were established to assist in the development of activities in particular sectors or according to functional lines, and the bureaucracy proliferated.

By the time the JLP government came to power in 1980, it was felt that the existing array of agencies was for a variety of reasons ill-equipped to implement the new private sector development program. Therefore, yet another series of organizations was created to assist in this effort. Given the political and bureaucratic problems and delays associated with disbanding and/or reorganizing government organizations in the Jamaican context, the government chose to superimpose these new bodies on the existing framework rather than undertake the difficult exercise of whole-sale reorganization. The inevitable result has been a number of overlaps in functional activities and a natural jockeying for power within the system.

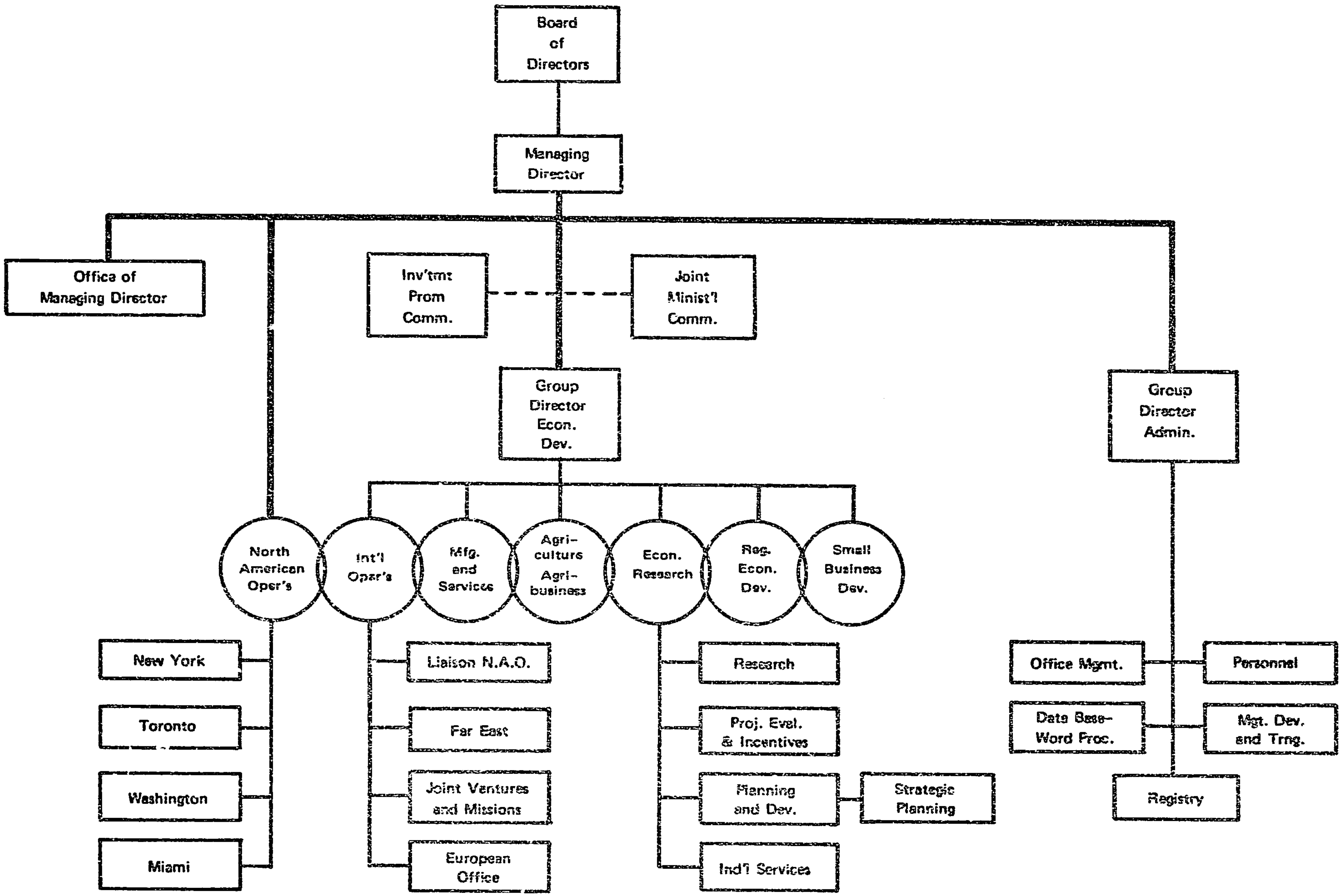
The following section describes briefly the organizations and functional activities of those government bodies charged with encouraging or promoting private sector investment. Attention will be focussed on those efforts most closely aligned with the parameters of this study. A more extensive organizational analysis can be found elsewhere.[10]

Jamaica National Investment Promotion, Ltd. (JNIP): The JNIP is clearly most important among the various authorities involved with promoting investment in Jamaica. Established in mid-1981, the JNIP was originally designed as a promotional arm of JIDC, but soon came to report directly to the Prime Minister. The JNIP is in theory responsible for the promotion of both foreign and local investment into all sectors of the Jamaican economy, including manufacturing, agribusiness, tourism, construction and housing. In practice, as will be discussed below, a number of other authorities do involve themselves in promotional efforts.

The JNIP staff has grown from a small number of individuals at its inception to a current staff size of about one hundred. As it has grown, the JNIP has undergone several reorganizations. Currently it is divided into two principal divisions (shown on the following chart): an operations division (cited as "Economic Development") and an administrative division.

The Economic Development Division, with a staff of 60, is composed of a number of separate functional units. The Manufacturing and Services Group (with a staff of about 15) encompasses activities involving manufacturing, tourism and filmmaking, construction and minerals and chemicals investments. The Agribusiness Group (staff of 7-8) handles agricultural and food processing investments. The Economic Research Group (staff of 19) contains units on planning and development (investment profiles), research and data, project evaluation and incentives, and industrial services. The Regional Development Group (staff of 3) works with Jamaica's parishes to establish development committees. The Small Business Development Group promotes new investments and provides services (e.g., loan packaging and marketing advice) to small businesses. The International Operations Group (staff of 7) maintains contact with JNIP's overseas activities, provides liaison services for joint Jamaica-foreign business committees and deals with joint ventures. The North American Operations Group works closely with the International Operations Group but reports directly to the Managing Director of JNIP. The North American Operations Group essentially maintains offices in New York, Washington, and Miami.

The annual budget of JNIP is listed officially at about J$7.3 million for 1982, and a similar expenditure level is anticipated for 1983. JNIP receives its funding from the Capital Development Fund administered by JNIC.



JAMAICA NATIONAL INVESTMENT PROMOTION LTD ORGANIZATION

The bulk of the functional activities of the Economic Development Division of JNIP (with the exception of the Economic Research Group) is conducted by "EDEs", or Economic Development Executives. The work of EDEs is functionally mixed between investment promotion and investor assistance. In the past, EDEs tended to specialize in particular industries, but their efforts are now more general in scope. Essentially each EDE maintains a portfolio of investment projects which he or she manages from the time of initial inquiry until the investment is implemented. The EDEs work on behalf of potential investors in developing investment applications and securing approvals from the various industries involved. Given the relative complexity of the approval process and the lack of research and administrative capacity of many small investors, the role of investor assistance has become increasingly burdensome for the JNIP staff.

JNIP's promotional activities are discussed later in this report, but one can conclude overall that they cover nearly the entire range of possibilities. In its short history, JNIP can be described most aptly as hyperactive, although it has progressed through several phases. During its initial year and a half of operation, JNIP took as its first priority changing the image of Jamaica as an investment site. Hence JNIP sought to restate the range of existing investment incentive laws in a positive way and to organize JNIP as a "one-stop shop" for potential investors. A great deal of renewed investor interest was generated by promotional visits by Prime Minister Seaga, and so the JNIP was forced into a reactive mode in which staff members remained busy merely responding to inquiries. During its second year, JNIP showed greater initiative in its own promotional activities and its efforts became more specifically targeted. Currently, JNIP has entered a third phase of even greater selectivity.

The JNIP has made considerable achievements in its short history in terms of establishing a multi-functional organization and conducting a broad range of promotional activities. The strength of JNIP stems from its energetic staff, the fact that its activities represent the cornerstone of the government's current development strategy, and a close working relationship with the Prime Minister. These positive factors have in turn given rise to animosity on the part of competing agencies, which has complicated JNIP's task of acting as an interagency coordinating body on investment related issues.

The track record achieved by JNIP in terms of actual new investments brought to fruition is discussed in greater length in the concluding section of this report. However, one can observe in a general sense that achievements in this regard have fallen short of expectations, primarily because expectations were unrealistically high. The basic problems encountered, both past and present, have been the slack international economy, the less than attractive Jamaican investment climate in general, and bureaucratic constraints, all of which were beyond the control of the JNIP.

The efforts of JNIP have not, however, totally escaped criticism from both private and public sector sources. One major problem cited was the failure at the outset to give JNIP any statutory authority to conduct its mandated task. This being the case, JNIP personnel attempt to "work the system" of agency and ministry approvals by means of JNIP's close working relationship with the Prime Minister. Other critics claim that JNIP abandoned its originally stated strategy of "spear fishing" (highly targeted promotion) in favor of "net fishing" in order to achieve numerical goals on numbers of investments implemented. Local business executives made note of a "creative" use of statistics on new investments, and asked rhetorically, "Where are these investments? I would like to see them." Finally, others suggest that JNIP is addressing the investment promotion function from the standard Jamaican approach of creating a bloated bureaucracy which will eventually lose sight of its originally determined task. Undoubtedly some of these criticisms are valid, while others are founded in jealousy arising from JNIP's privileged status within the government machinery.

Jamaica Industrial Development Corporation (JIDC): JIDC was created in 1952--making it one of Jamaica's first statutory authorities--as an all-encompassing "Fomento" to accelerate the growth of industry and agriculture in Jamaica. Initially considered both powerful and effective, JIDC experienced a gradual decline over the years due to the loss of its most qualified staff members, the creation of other authorities which assumed many of its functions such as export promotion, and general bureaucratic frustrations and inertia caused by the development policies of the 1970s.

Many of the activities previously carried out by JIDC are for practical purposes moribund, although they remain in at least a symbolic sense. In terms of real functions, JIDC is known primarily as a body which constructs and maintains industrial estates and factories throughout Jamaica. As such, it is one of many entities involved in factory construction.

In addition, JIDC remains actively involved in training programs through its Training Department, Food Technology Institute, Toolmakers Institute, Repairs and Maintenance Training and Demonstration Unit, Management and Technical Services Department, and Garment Industry Development Unit. The JIDC also serves as a holding company for a number of public enterprises and administers two government funds.

The total staff size of JIDC is approximately 180, most of whom are engaged in factory space provision. Most of those officials interviewed, from both the public and private sector, conclude that JIDC is largely moribund since most of its originally assigned tasks have been transferred to other bodies. All of JIDC's investment promotion activities have been assumed by JNIP.

<u>National Industrial Development Company Ltd. (NIDCO)</u>: NIDCO was created in 1982 to provide management assistance to "rehabilitate" a select number of firms in seven industrial sub-sectors: garments, footwear, furniture, food processing, building products, automotive parts, and electronics. To date, NIDCO's program has become operational for garments, footwear and furniture, and the remaining sub-sectors will be added in 1983.

NIDCO's activities are oriented toward providing potential export industries with technical assistance in the form of diagnostic studies and training programs. To date these activities have been conducted primarily for the apparel industry through the services of two foreign consulting firms, the Singer Company and Kurt Salmon Associates. NIDCO chooses for assistance firms which demonstrate a capacity for success. Currently, services are offered free of charge. In the future, the company and NIDCO will establish performance targets in terms of new jobs created and foreign exchange earnings. If the firm reaches its targets, then consulting services rendered by NIDCO will be extended free of charge. If not, then the firm must pay for a portion of these services. An example given was that about J$100,000 of free consulting services could be provided for about 150 new jobs created over a twelve month period, or for equivalent foreign exchange earnings converted at about J$3,500 per job. The program is sufficiently new to warrant any conclusions as to effectiveness.

NIDCO's current staff size is 33, but will ultimately grow to about 100. The current budget is about J$3.0 million. NIDCO is a private company which is registered as a subsidiary of JIDC but in effect reports to the Ministry of Industry and Commerce. At present, NIDCO's functions are similar to those of a management consulting house which diagnoses problems encountered by manufacturers (input and quality control, marketing, etc.) and recommends and oversees the implementation of solutions. In the future, NIDCO also plans to develop and administer a major apparel production center as well as to provide island-wide management assistance.

<u>Kingston Export Free Zone (KEFZ)</u>: The KEFZ was created in 1976 to act as a warehousing site and transshipment center. Operated under the Port Authority, the zone did not work well as an economic venture and nearly collapsed in the late 1970s, when capacity utilization ran in the range of 20-30 percent. In the early 1980s, the zone experienced a wide swing in activity, from a high level at the end of 1980 to an almost total drop off by mid-1981. In May, 1982, the KEFZ was transformed into a "private" company with 60 percent of its shares held by the Port Authority and the remaining 40 percent by the Ministry of Finance, operating on behalf of World Bank funds which supported the zone.

The free zone authority is divided into three divisions: marketing, finance and administration, and engineering. The latter division constructs and maintains buildings within the zone. The zone now consists of some 35 buildings, but an additional 26 will be added in 1984. The KEFZ authority attempts to attract investors through the special provisions of the Free Zone Act (duty free, quota free imports, absence of foreign exchange controls, etc.) and the provision of factory space and security at cost.

The free zone factory sites have begun to reach capacity with the implementation of several large export ventures, primarily in the apparel industry. Current employment in the KEFZ factories is about 1,000, but based on projected factory rentals, employment is expected to rise to 2,357 in 1984 and to 5,447 in 1986. The KEFZ itself is expected to operate at a deficit until 1988 due to below-cost rental rates. However, the foreign exchange contributions of the zone are anticipated to rise from U.S. $4.0 million in 1984 to about U.S. $9.0 million in 1986.

The KEFZ conducts promotional activities, duplicating the efforts of JNIP, and constructs factory sites, duplicating the work of JIDC. The promotional activities of KEFZ are seen as required as a condition associated with the World Bank loan. Typically, KEFZ presonnel accompany JNIP personnel on investment missions, but KEFZ carries out its own marketing, concentrating on investments from Far Eastern firms.

Jamaica National Export Corporation (JNEC): The JNEC was formed in 1969 to expand Jamaican exports via promotion and assistance to domestic producers. As demand for Jamaica's traditional export commodities has slackened, the JNEC's efforts have come to focus on "non-traditional" exports, i.e., those other than bauxite/alumina, sugar and bananas. The promotion of cocoa, coffee and spices is handled by the Commodity Board.

JNEC is organized under the Ministry of Foreign Affairs and Foreign Trade, and views its basic role as two-fold: export promotion *per se*, and assisting the Jamaican private sector to meet the nation's export goals.

In this effort, the JNEC conducts research, training programs, and promotional activities.

JNEC's total staff of 95 is divided roughly evenly between Administration, Promotion and Trade Commissioner Service, and Trade Intelligence Divisions. Six Trade Commissioner offices are maintained abroad, one each in Port au Spain, Miami, New York, Toronto, London and Bonn, and a Trade Correspondent is maintained in Hong Kong.

JNEC has concentrated on the promotion of manufactures, but has recently become more involved with fruits and vegetables. Promotional activities include participation in trade fairs, the organization of inbound and outbound trade missions, preparation of displays, and point of sales distribution. Exporter assistance activities include the development of market intelligence, liaison with overseas markets and programs to explain the export process to local producers.

Along with the Bank of Jamaica, the JNEC owns the Jamaica Export Trading Company (JETCO), a trading company organized to market products produced by public and private sector enterprises. It is anticipated that JETCO will soon be merged with the Jamaica Commodity Trading Company (JCTC), a large organization (staff of about 180) charged with the responsibility of administering bulk imports of raw materials and finished products for consumption in Jamaica.

JNEC maintains links with the KEFZ, due in part to their overlapping objectives and in part to the fact that one individual serves as chairman to both organizations. The current JNEC budget runs at approximately J$4.6 million, and has been declining gradually in real terms.

Jamaica National Investment Corporation (JNIC): The JNIC was established to act as the government's representative vis a vis the bauxite industry, and specifically to collect and invest the government's bauxite levy via the Capital Development Fund. The current staff of about 56 report to the Ministry of Finance and Planning.

The primary function of the JNIC is to invest in large public sector projects. As such, JNIC acts as holding company for about nine parastatal firms engaged in industrial and agricultural production. Before the creation of JNIP, JNIC acted as a clearinghouse for investment inquiries, which JNIC forwarded to the relevant agencies or ministries. JNIC's current role in private sector investment promotion is as a source of funding for JNIP.

Other Official Agencies: A number of other government organizations are involved to certain degrees with the government's efforts to stimulate private sector activity. The Agricultural Credit Bank (ACB) and the National Development Bank (NDB) were established recently, in 1982 and 1983 respectively, as successors to the Jamaican Development Bank, which was forced in 1981 to cease lending due to a poor record on loan recovery. The ACB and NDB act as wholesale banks for the extension of loans and assistance to agricultural and industrial ventures.

The Jamaica Export Credit Insurance Corporation (JECIC) was formed to provide exporters with insurance against political and commercial risks, but has expanded its activities to include general export financing. The Agricultural Marketing Corporation (AMC) acts as a purchasing agent for locally-produced agricultural products with the objective of expanding local output and stabilizing market conditions. The Bureau of Standards carries out the traditional function of ensuring that local products meet minimum health and safety standards, and recently the Bureau's efforts have been expanded to encompass foreign standards for products with export potential.

The Project Analysis and Monitoring Company (PAMCO) was created in 1979 to act as a central organization for analyzing and monitoring projects funded by foreign sources. This role was expanded subsequently to include locally funded projects. The Trade Board is charged with the functionally simple but politically difficult task of administering procedures related to the issuance of import licenses. Under current conditions of severe foreign exchange shortages, the Trade Board has become a focal point for criticism by private sector executives.

IV. PRIVATE SECTOR ACTIVITIES

Individuals, corporations and associations in Jamaica's private sector have experienced the detrimental effects of the pendulum swings of public opinion and government policies between pro- and anti-private enterprise attitudes. The private sector has been generally supportive of the current government strategy, but the lack of demonstrable economic progress and the persistence of the government-based problems noted above have led to a growing sense of frustration and cynicism.

During the 1970s, most organizations focussed their efforts on merely preserving the private sector from the growing size and scope of government. In recent times, these groups have sought to play a more positive role, but their offers of assistance have been less than fully utilized.

The Private Sector Organization of Jamaica (PSOJ) serves as an umbrella group for most private sector entities operating in Jamaica. Its total membership of more than 300 includes individuals, companies and other associations. The PSOJ hopes to double its current staff of six in order to expand its activities. Having lost some of its vigor following the election of the current government, the PSOJ is seeking to rejuvenate its efforts to include the following functions: provide macroeconomic assessments, act as a private sector counterpart to JNIP in assisting potential investors, liaising with bilateral business councils, acting as a broker for technical assistance, and continuing to carry out its role as a watchdog over government policies.

While the PSOJ is oriented toward national issues, the Jamaica Manufacturers Association (JMA) focusses on sectoral interests. The JMA has about 600 members and is organized on product group lines. The current staff size is about 12. In functional terms, the JMA combines lobbying activities with services provided to members, such as bulk purchasing. In terms of investment promotion, JMA members sit on sectoral advisory committees organized by JNIP, and participate to a limited extent in JNIP investment missions. The JMA in additon undertakes its own missions, such as a recent group which travelled to the United States to engage a select number of U.S. electronics firms.

Other Jamaican groups serving the interests of particular sectors include the Jamaica Exporters Association and the Small Business Association, but the involvement of these groups in investment promotion is limited. Finally, a large number of corporate executives serve on an individual basis, often *pro bono*, as members of the governing boards of Jamaica's numerous statutory agencies and public enterprises.

V. INVESTMENT PROMOTION ACTIVITIES AND TECHNIQUES

As noted previously in this report, Jamaican government entities, primarily the JNIP, have performed a hyperactive set of promotional activities in a period of just over two years. These include nearly all known forms of promotional techniques.

A. Brochures and Publications

For a country and economy the size of Jamaica, the number of publications available to potential investors is sufficiently large to create some confusion. A number of brochures provide a general introduction to Jamaica. Separate pamphlets describe the following: "Starting and Operating a Business in Jamaica," "Government Duties and Taxation," "Moving to Jamaica," the "Investment Incentives Program," "Labour and Labour Legislation," "Establishing an Off-Shore Apparel Operation in Jamaica," and "Agro 21" on the government's agricultural programme.

In addition, the JNIP has prepared "Industry Profile" brochures describing the production and export potential of industries such as coffee, footwear, beverages, and cigars. A separate series of short pamphlets make note of the potential of certain products included in the Caribbean Basin Initiative. One general and fairly comprehensive publication, *The Investor's Guide to Jamaica*, was prepared by a local consulting organization and is distributed by the JNIP. The JNIP also publishes a monthly JNIP News which discusses current developments. Other Jamaican authorities such as KEFZ and NIDCO produce their own information brochures and newsletters.

Overall, this published material is of professional quality, and as a whole conveys important information to potential investors. In fact, the material should serve to initiate or reinforce investor interest. However, as in most countries, the positive image projected does not adequately address problems which investors would inevitably face. In particular, the number of procedures and approvals required were cited by investors as not being presented sufficiently.

B. Advertisements

Over the past three years, the Jamaican government has expended a great deal of time and effort to change Jamaica's general image. Initially, advertising in newspapers and periodicals concentrated on Jamaica's new emphasis toward welcoming investment and tourism "again." More recently, advertising has become more specific in terms of both publications and industry orientation.

C. Seminars and Missions

Since its inception, the JNIP has conducted investment seminars overseas in Atlanta, Tampa, Toronto, West Germany, the United Kingdom, Hong Kong, the "Silicon Valley" and Singapore. JNIP officials also accompany the Prime Minister on his state visits, during which considerable investor interest is generated. The JNIP has also participated in a number of industry-specific trade shows, along with representatives from JNEC and KEFZ. Finally, JNIP conducted fact-finding missions in the East Asian nations of South Korea, Japan, Hong Kong, Taiwan and Singapore.

The JNIP has hosted a fairly large number of overseas investment missions in Jamaica, revolving around different target groups. Many of these were jointly sponsored by external groups such as OPIC, the U.S. Department of Commerce, the Miami Chamber of Commerce, or Canada's CIDA.

D. Direct Contacts

Thus far, Jamaica's promotional efforts have been focused more on general audiences than on specific firms, although there are cases of the latter. JNIP is now in the process of becoming more selective. Field offices are preparing lists of individual firms to target. Records are kept on participants at seminars, and JNIP follows up on each prospective investor. A study is currently being conducted to identify specific firms and product lines in Europe.

E. Field Offices

JNIP maintains branch offices in New York, Washington, and Miami. In addition, the Jamaica Trade Commissioner's Service provides the JNIP with representation in London, Toronto, Bonn and Port au Spain. The record of this latter system of representation is considered less than fully successful. The JNIP hopes to extend its network of branch offices to cover such areas as Chicago, Houston and San Francisco, the latter to handle both the western states and the Far East. In addition to these formal systems of representation, JNIP maintains an informal structure in its role as secretariat for bilateral business committees established jointly with the United States, the United Kingdom, West Germany, Canada, Puerto Rico and Venezuela.

VI. DIFFERENTIATION BETWEEN FOREIGN AND LOCAL INVESTMENT

The legal structure associated with business transactions in Jamaica does not, with a few minor exceptions, discriminate between domestic and foreign investment. During the 1970s, however, the direct and indirect actions of the government machinery tended to be heavily biased against foreign investment. Foreign firms were subjected to nationalizations and increasing levels of government regulations and restrictions, whereas local firms benefitted from various forms of subsidies. At the same time, the confiscatory fiscal system inhibited private company growth and economies of scale, since firms had major incentives to remain small and avoid keeping accurate accounting records.

The current government has made strides in removing the anti-foreign firm biases from the bureaucracy, although these remain to a certain degree. In terms of investment promotion, the major emphasis has been placed on attracting capital inflows. Outside observers have suggested that the level of effort placed on foreign investment versus indigenous investment runs on the order of magnitude of about four-to-one. This experience is more or less comparable to that of the other developing countries with active promotion programs.

VII. ASSESSMENT AND CONCLUSIONS

The ultimate performance of any investment promotion effort must be measured by the number and size of ventures attracted and implemented. According to figures released by the JNIP, since it was established in mid-1981, a total of 182 investment projects have been implemented with a total capital investment of about J$283 million (about U.S. $95 million). The majority of these investments in terms of both number and size were in manufacturing (75 projects) and agriculture (65 projects), with lesser numbers in tourism (15), small business (15), construction and housing (4) and other (8). Total actual employment at the time of the ventures' commencement of operations amounted to 4,855, with eventual potential employment rising to as high as 43,494.

In addition to projects implemented, JNIP as of November listed 65 projects as "finalized" (those for which all permits and approvals have been secured), 142 projects as "active" (an estimated 75 percent chance they will proceed), and 150 projects as "preliminary" (initial inquiries have been handled and the projects have become documented).

As of the end of 1982, the majority (55 percent) of investment projects were of Jamaican ownership. Foreign-owned ventures amounted to 28 percent of the total, with the remaining 17 percent representing joint ventures.

A careful examination of the figures, which are clearly presented in such a way as to present a positive statement on progress made, indicates that the majority of implemented investments are small and of Jamaican origin, and may or may not have come to fruition without the actions of government authorities. The number of new ventures implemented in 1983 dropped off somewhat from those of 1982, in part due to Jamaica's foreign exchange constraints, but also perhaps because flow of relatively "easy" investments (i.e., those which were postponed pending a change in government attitudes) has been essentially absorbed.

Even given the need to temper the performance indicators with a number of caveats, one can conclude that the Jamaican government, spearheaded by the JNIP, has been as successful as it could possibly have been in promoting private sector investment. The success of any marketing operation is determined ultimately by the quality of the product, and those promoting investment in Jamaica were faced not only with a poor international climate but also with an unattractive domestic environment.

The Jamaican government as a whole can be faulted with creating unrealistically high expectations for results from its overall program, and for placing most emphasis on marketing rather than improving the "Jamaican" product. Promotional efforts were assumed to be capable of overcoming, or at least papering over, fundamental flaws in the existing government structure as it relates to private investment. Unwarranted performance targets were set in effect for both the JNIP and the Jamaican private sector itself, which led to shotgun promotional efforts and relatively large expenditures without commensurate returns.

The basic problems noted at the outset of this report remain, and will continue to stymie efforts to attract new investments. The government has come to acknowledge this fact, and nascent efforts to improve the bureaucratic and regulatory structure are now being seriously considered. Those involved in these efforts should realize that the objective being sought requires both fundamental changes and a fairly lengthy gestation period. Immediate successes will prove ephemeral.

One specific problem which needs to be remedied is the fact that the primary promotional authority--JNIP--is not integrated into the government's "investment process" except through personal relationships. Terms such as consolidation, streamlining and simplification of governmental organizations and procedures are used often in Jamaica, but little visible progress in this area has been recorded.

The management of a number of government authorities associated with investment promotion can be characterized as competent and highly motivated. Problems encountered are typically blamed on the "system" which is considered difficult if not impossible to change. It is precisely the "system" which remains the primary deterrent to new investments in Jamaica.

FOOTNOTES

1. Michael Massing, "The Jamaica Experiment," The Atlantic Monthly, September 1983.

2. Jamaica is generally considered as being one of the most excessively studied and analyzed countries in the world. According to The Economist of February 12, 1983, "From the end of 1980 to the beginning of 1983 there have appeared some 1,500 reports, surveys, feasibility studies and outlines of projects on almost every aspect of Jamaican life--according to a consultant dispatched from New York to count them."

3. Cited in "Final Report: Study on the Institutional Framework of the Industrial Sector in Jamaica," Development Associates, Inc., prepared for the United Nations Development Programme, April, 1983, p. I-1. (Hereafter cited as Institutional Framework Study).

4. "Jamaica: Development Issues and Economic Prospects," Report No. 3781-JM, January 29, 1982, p. 38.

5. Institutional Framework Study, p. IV-1.

6. "Foreign Investors' Attitudes Toward Jamaica," Study conducted by the U.S. Business Committee on Jamaica, Inc., November, 1983.

7. Mahmood Ali Ayub, Made in Jamaica: The Development of the Manufacturing Sector, World Bank Staff Occasional Paper Number 31, 1981, p. 80.

8. The Investor's Guide to Jamaica, Jamaica National Investment Promotion, Ltd., 1982.

9. Investment Incentives Programme: The Government of Jamaica, published by Jamaica National Investment Promotion, Ltd. (date unknown).

10. Institutional Framework Study, Appendix A.

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Development Associates, Inc., "Final Report: Study on the Institutional Framework of the Industrial Sector in Jamaica," prepared for the United Nations Development Programme, April, 1983.

Jamaica National Investment Promotion, Ltd.

- Annual Report 1982
- The Investor's Guide to Jamaica, 1982
- Industry Profiles
- Investment in Jamaica
- Brochure series on: establishing an offshore apparel operation in Jamaica; government duties and taxation; starting and operating a business in Jamaica; labour and labour legislation; moving to Jamaica
- Investment Incentives Programme

Kingston Free Zone Co., Ltd., Fact Sheet for Corporate Decision Makers.

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EGYPT

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I. INTRODUCTION: THE HISTORICAL HERITAGE

The ability of any government to attract private sector investment from both domestic and foreign sources is heavily dependent on the quality of the country's investment climate. On this count, Egypt's historical reputation has been marred by a number of factors, both external and internal. In addition to facing problems associated with the investment climate itself, Egyptian promotional efforts have been undertaken in a fragmented and inconsistent fashion, and the investment application and review system has been deficient in a number of key respects. It is not surprising, therefore, that Egypt has not enjoyed great success in attracting private sector investment.

There is recent evidence that, in recognition of these problems, the Egyptian government is currently undertaking steps to organize its investment related activities more effectively. Ongoing promotional efforts have been scaled down over the past year, and greater attention has been placed on determining national investment objectives and priorities more clearly, and on identifying and overcoming problems related to past investment promotion efforts and application processes. After this year of self-evaluation and foundation-building activity, the appropriate government authorities may now be poised to execute an active, coordinated investment promotion program.

The development of a viable private business sector in Egypt has been hampered by a host of economic, political and social factors. Egypt's relatively low level of economic development, particularly in regions outside the major urban areas, has confronted private firms with a lack of effective demand and physical infrastructure. The process of economic development has tended to widen income disparities and has concentrated purchasing power in the hands of the relatively small upper-income groups.

Equally and perhaps more important as a deterrent to private investment has been the widespread distrust of private enterprise held both within government circles and throughout the general population. The practical implications of this body of opinion in terms of government policies were felt most strongly in the 1960s and early 1970s, when an emphasis was placed on building the size and power of public enterprises.

Current estimates suggest that as much as three-fourths of Egypt's total non-agricultural output is controlled, directly or indirectly, by government enterprises. Since many basic goods are heavily subsidized, public sector ownership and control has gained wide acceptance. The price distortions caused by these activities have in turn created strong biases against private businesses. Almost one decade after the announcement of the "Open Door Policy" and the policy shift favoring private business, the basic attitude of skepticism remains and is manifest in terms of bureaucratic decisionmaking, media coverage and public acceptance of new business ventures.

A major impediment to change in attitudes and policies has been the role that Egypt's Middle East location plays in shaping the concerns of Egyptian policymakers. For over three decades Egyptian leaders have focused their attention primarily on military and political matters rather than economic concerns. In addition to the commitment of large portions of scarce budgetary and management resources to defense, the natural tendency for a country beset with a long term external threat is to seek greater control over internal affairs in order to maintain economic and social order. The sum result of this ordering of priorities has been a relative neglect of economic development and a skewing of policies and practices in favor of the public sector at the expense of the private sector.

While the foregoing factors have had a retarding impact on both domestic and foreign investors, the latter face an additional challenge. The history of Egypt's post World War II foreign relations has led to an attitude of anti-colonialism. The pride of Egyptian's toward their own cultural heritage, coupled with major shifts in Egypt's foreign alignments, have made Egyptians wary of foreign enterprise involvement in the economy.

These and other problems which are examined below have continued to plague both government and non-government efforts to stimulate private investment. The outright failure of recent promotional activities has confirmed that much more basic difficulties must be addressed before any promotional program can yield reasonably successful results.

II. THE CURRENT STRUCTURE FOR INVESTMENT PROMOTION

As in many developing countries, early Egyptian efforts to stimulate private investment were targeted at attracting foreign capital inflows rather than at encouraging indigenous enterprises. Hence, the early legal and organizational structure was oriented toward transactions involving foreign companies.

To fill the gap between Egypt's domestic savings and projected investment needs, the government has actively sought foreign investment since 1974. In that year, President Sadat announced the so-called "Open Door Policy," known in Egypt as Al-Infitah, which is embodied in Public Law 43. This law provides for repatriation of profits from joint venture investments and exemption from certain taxes, customs duties, profit-sharing requirements and labor laws.

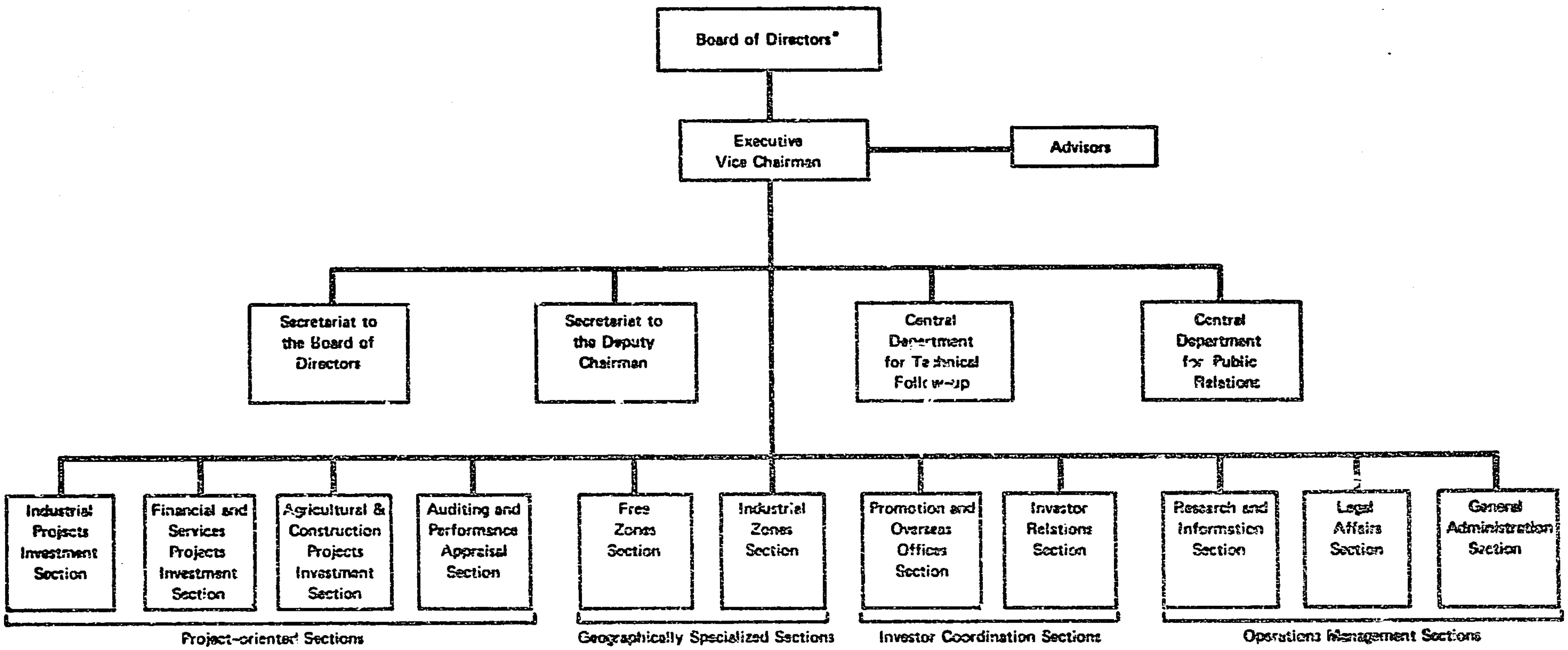
Because certain provisions of Public Law 43 conflicted with previous legislation, Law 32 was passed in 1977 asserting the primacy of Public Law 43 over any conflicting laws. Law 32 was also intended to allow import substitution investments as much encouragement as Law 43 offered to export-oriented businesses. The 1977 Law 32 action also made it clear that indigenous investments could benefit from the Law 43 incentives if the proposed project met the Investment Authority standards for approval. As a further step to attract capital inflows, duty free zones were established in the Suez Canal city of Port Said, in Alexandria, and in the new Nasr City.

Law 43 benefits are generally available to foreign investors who establish joint ventures with Egyptian companies, public or private, or with Egyptian individuals. Free zone projects, however, are exempted from the local participation requirement, as are any Law 43 projects voted an exemption by the Board of the Investment Authority.

Recent statistics available from the Investment Authority seem to indicate that the Open Door Policy has, in fact, been successful in attracting indigenous investments. For all inland projects, about two thirds (64.7 percent) of the authorized capital is Egyptian, with wholly-owned Egyptian companies comprising 40 percent of all projects approved. Non-Arab foreign investors represent approximately 20 percent of total equity capital (the U.S. share is 5 percent) in inland projects; Arab investors 15 percent.

Various Egyptian businessmen with whom the SRI project team met asserted that a substantial portion of the new capital flows tapped by the Open Door policies represent the wealth of Egyptian expatriates who have returned home with wealth, in part, generated abroad. The investment incentives of Laws 43 and 32 appear to have helped to dramatically improve the investment environment, a reality perhaps clearer to Egyptians than prospective foreign investors. As this report points out later on, changes in the legal environment are not in-of-themselves-sufficient to attract new investment if the bureaucracy charged with implementing these laws is unresponsive to legislative intent. No matter how favorable the legal environment, difficult regulatory regimes can be expected to have a serious dampening effect on potential foreign investors, particularly those who are unfamiliar with the local investment maze. Foreign investors also can be expected to weigh the relative advantages of one country's investment climate against the merits of another competing environment.

Law 43 vested principal government responsibility for investment stimulation in the General Authority for Investment and Free Zones (hereinafter referred to as the Investment Authority). As is evident from the roster of its Board of Directors (shown below), the Investment Authority is largely a coordinating body of those senior Egyptian officials from throughout government who have an interest in economic issues.



* Chairman: Minister for International Investment and Cooperation

Ministers: Finance
Industry & Wealth
Electricity and Energy
Economy and Foreign Trade
Planning
Rehabilitation, Housing & Land Reclamation
Tourism and Civil Aviation
Agriculture
Representative of Minister of Petroleum
Chairman of General Authority for Stock Market
Governor of Central Bank
Deputy Chairman of Investment Authority
Counsellor of State for Advisory Dept. in State Counsel

ORGANIZATION OF THE EGYPTIAN INVESTMENT AUTHORITY

The Investment Authority's "Official Guide to Investment in Egypt" states that:

> The Investment Authority was created with the idea that it would have a hand in virtually every aspect of the investment process...[1]

While this statement is undeniably true, it is equally clear that many of the investment difficulties highlighted later in this report are often traceable to the Authority's needs to harmonize the disparate interests and perspectives of its Board before it can act.

In its review of alternative designs for an Egyptian Investment Information Center prepared for the Investment Authority, Arthur D. Little International states,

> While Law 43 defined extensive functions for the organization, the Authority was not granted precedence over other agencies in the performance of these tasks, and in practice must share the field with a number of other bodies in the Government. This shared authority is primarily in the control and regulation of investment, particularly the granting of approvals for investment under Law 43, on which other agencies have strong influence, and the monitoring of compliance with regulations. In the areas of program planning, research, promotion, and facilitation of foreign investment, however, the Authority has been given a virtually exclusive franchise.[2]

This bifurcation of authority for investment approval/regulation and investment promotion presents the Authority with fundamental difficulties in its efforts to effectively facilitate new investment.

As is discussed at the conclusion of this report, the Investment Authority acknowledges past difficulties and has undertaken certain remedial steps to better rationalize the Authority's decision-making process.

Given these organizational difficulties, the rather disappointing response to Law 43 (particularly with respect to new "foreign" investment)

Required of all Law 43 Investment Projects:

Department	Official
• Work Permits, Ministry of Labor	Director General
• Commercial Registry	Director General
• Legalization (General Notary)	Director General
• Passports and Immigration, Ministry of the Interior	Director General
• General Organization for Industrialization	Director
• Department of Taxation, Ministry of Finance	Director General

Additional approvals required depending on the type of project

strial and ral Wealth
stry of Industry Mineral Wealth
ral Organiza- for Industrial- on

Pharmaceuticals, Cosmetics, Medical Supplies & Equipment, Hospitals
• Ministry of Public Health

Tourism and Civil Aviation
• Ministry of Tourism and Civil Aviation

Transportation
• Ministry of Transportation

Banks
• Central Bank

Housing, New Communities, Barren Land Reclamation
• Ministry of Rehabilitation and State for Housing and Land Reclamation

Animal Husbandry, Aquatic Resources, Food Processing
• Ministry of Agriculture and Food Security

GOVERNMENT APPROVALS REQUIRED OF LAW 43 INVESTMENTS is not surprising, nor is the relatively low level of sustained and focused effort devoted to investment promotion activities by the Investment Authority.

III. PROBLEMS ENCOUNTERED

The Egyptian experience in investment promotion can be described as a classic example of good intentions leading to a set of activities which were not developed and implemented according to any coordinated long term strategy. Not only were the preliminary steps crucial to the formation of an effective promotional effort were not taken, in many respects the sequence of actions taken was inappropriate, leading to counterproductive, costly mistakes.

The inevitable result of the lack of a well-conceived plan has been an unbalanced and inconsistent promotional program involving unrealistic expectations, and achieving very limited results. Many of these problems are now readily acknowledged by Egyptian officials, who over the past year have initiated a number of important corrective measures which start at the basics.

For the didactic purpose of drawing lessons for other countries, the following analysis of the Egyptian experience focuses first on the many difficulties encountered in investment promotion. This is followed by a discussion of developments currently underway which seek to remove or at least alleviate the obstacles experienced.

Investment Climate Assessment

One of the principal problems facing investment promotion efforts has been a fundamental misperception among Egyptians of the relative attractiveness of the Egyptian business climate. Egyptian promotional material has portrayed Egypt as a highly attractive general investment climate, reflecting a point of view generally shared by everyone except prospective investors. The three factors most often cited as favoring Egypt's business climate are the large domestic market, Egypt's inexpensive and relatively skilled labor pool, and Egypt's favorable location as an export base to Arab and African markets. From the perspective of any knowledgeable investor, these advantages are highly exaggerated.

Egypt's large population of 46 million appears to represent an attractive potential market, but the actual purchasing power of the vast majority of the population is far less than that in some neighboring countries with much smaller populations. Much of the skilled labor force has left Egypt to work in other Arab countries. While every Egyptian university graduate is by law guaranteed a state job, the wages for such positions are minimal. Since the private sector is too small to absorb more than a minority of these applicants, the more qualified often find work outside the country. This system has also led to excessive overstaffing of government agencies, causing standard bureaucratic inertia.

The advantage of Egypt's geographic location is also overstated. Egypt does not benefit from any preferential access to other Arab markets, and in fact suffers from official boycotts in several cases. Therefore, manufacturers of non-bulky goods can often gain access to Arab and African markets just as easily from points as far away as Singapore or Ireland, or as nearby as Tunisia.

The promotional material notwithstanding, there is an almost universal attitude among potential investors that the Egyptian investment climate is fraught with problems. According to a recent GAO report, U.S. businessmen and institutions who evaluate country risks rank Egypt's business climate at the low end of the scale of those less developed countries which are in competition for foreign investment.[3] This assessment was borne out by information gathered and interviews conducted by the SRI project team.

Little can be done in the short run to overcome basic structural deficiencies. However, a realistic evaluation and presentation of Egypt's investment "assets and liabilities" would better serve promotional efforts. The most successful investments have been those which take advantage of Egypt's domestic market (e.g., ventures by pharmaceutical manufacturers, food manufacturers and processors) or of Egypt's natural resource base (primarily petroleum operations). These investors have chosen to conduct business in Egypt in spite of the climate's many difficulties; not because they perceive the business environment to be particularly welcoming or easy. It should be noted that investments in the petroleum sector are not governed by the Investment Ministry, but rather by the Ministry of Petroleum under a set of streamlined and expedited procedures. For some but not all investors, the difficulties of investing in Egypt may be outweighed by opportunities in their particular field, but for most investors, the problems encountered have proven compelling.

While few countries, developed or developing, are totally devoid of structural economic problems, private firms have learned how to operate profitably in nearly all environments. Ultimately, governments can address these problems only over time. However, they can undertake internal reforms aimed at improving the business climate, particularly when the government itself is viewed as a major part of the problem.

The most frequently cited deterrent to private investment in Egypt is the government bureaucracy. A survey by Chase National Bank reports that companies with investment experience in Egypt almost unanimously agree that the difficulty in communicating and dealing with the government ministries, authorities, and the public sector ranks as the most pressing constraint to investment.[4] Nearly all studies of the Egyptian business climate confirm that the major obstacles encountered by U.S. (and other) firms tend to revolve around the bureaucracy.[5]

In addition to the problems associated with the investment application process which are described below, private firms must also deal with policy selectivity and reversals. Investors have experienced numerous inconsistencies between the incentives granted to them on paper and those actually implemented once operations have begun. For example, customs duty exemptions have in many cases been ignored by the Customs Authority, whose personnel are often described as being a law unto themselves, resulting in the lack of a uniform, stable and predictable tariff structure.[6]

Similar problems arise in investment agreements. For example, an exclusive market arrangement with Wilkinson Match reportedly fell apart in 1978, when the Investment Authority granted a production license to Wilkinson's U.S. competitor, Gilette, despite a five-year agreement with the British company.

Other governmental-related deterrents involve preferential treatment received by public sector companies in such areas as access to foreign exchange, and subsidized utility rates and raw material costs. Overall, the basic problem involves the ambiguous and sometimes hostile attitude in government circles toward efforts to increase the "privatization" of the economy, despite high-level policy pronouncements encouraging private sector expansion.

The Approval Process

The approval process for investment applications in Egypt has long been considered one of the most onerous ordeals facing prospective investors. The creation of the Investment Authority was intended to correct the problem whereby prospective investors had to move through a veritable maze of Ministry approvals, the failure to get any one of which constituted a veto of the project. However, the increases in efficiency achieved by implementation of Law 43 have fallen short of expectations.

According to investors, the Authority has continued to take an unduly long time--in some cases several years--to reach decisions and grant approvals, largely because the approval process has perpetuated the effective veto power held by individual ministries. As indicated earlier in the report, the Board of Directors of the Investment Authority consists of the Ministers of Industry, Agriculture, Planning, Electricity, Housing, Tourism, and other ministries of standing. Concurrence by the Board of Directors is necessary to obtain final investment approval. By law only a majority of votes is required for approval (with certain exceptions, e.g., a two-thirds majority is needed for approval of 100% foreign-owned project). There is evidence, however, that deference may have been given in the past to any single ministry with particularly strong objectives to any given investment. Hence a veto system has remained, in this case *de facto* rather than *de jure*.

Another problem encountered by investment applicants was the recurring question of the "completion" of the application. A number of companies have characterized the review and approval process as "nit-picking", unduly concentrating on minor issues which are handled sequentially rather than simultaneously. Ongoing requests for additional information contribute to a lengthy, time-consuming effort.[7] The resulting delays give rise to a "Catch-22" situation in which investors must undertake new feasibility studies and change prices or strategies, thus opening them up to additional requests of information.

IV. INVESTMENT PROMOTION ACTIVITIES

The Egyptian government has undertaken a number of efforts (dating back to the announcement of the Open Door Policy) which are aimed at promoting the investment climate. These include many of the techniques generally employed by other countries. In large part, however, one must conclude that these activities were carried out prematurely, and until recently were fragmented and inconsistently organized. The high cost of these efforts, coupled with an apparent lack of results has led to frustration on the part of the officials responsible for investment promotion efforts. This frustration has, in turn, led to a series of on-again, off-again projects and programs. The history of the Egyptian investment promotion office in the United States provides an apt example.

The U.S. Promotion Office

The problems encountered by the Egyptian investment promotion office surfaced from its very inception, when it was decided to locate the office in Washington, D.C., despite the lack of a significant corporate presence in Washington. The office was opened in February, 1975. One justification provided for the Washington location was the fact that Iran had cited the success of its offices in Washington. However, as noted by one observer, "In 1975 Iran could have located its investment promotion offices in Alaska, and people would have gone to it."

After five months of inactivity, the office was moved to New York. The New York office had three changeovers in directors before being closed in the mid 70's, reopened under yet another director shortly thereafter, and closed for a second and final time in 1980. Throughout this period the operations of the office reportedly were deeply affected by personal power struggles and shifting signals. Even under the best of circumstances, the constant moves, closings, openings and changes of leadership would have rendered such an undertaking ineffective.

A major organizational difficulty encountered was insufficient coordination between the New York office and the Investment Authority in Cairo. In one example, the investment promotion office attempted to persuade a certain U.S. manufacturer to seek to establish a manufacturing plant in Egypt at the very time the Investment Authority was opposing the entry of that particular manufacturer into Egypt. In other cases, when potential investors were persuaded to make exploratory visits to Egypt, there would often be no official assistance arranged for them during their stay in Egypt. In numerous instances prospective leads generated in New York were not pursued once the center of discussions shifted to Cairo.

Similar to the experience of many countries, these promotional efforts also suffered from unrealistic expectations. Large quantities of investment were expected to result directly and quickly from the New York office's activities. Cairo-based officials apparently failed to appreciate the long gestation period required for investment promotion efforts, and consequently exerted pressure on the New York office for quick results. As noted by one experienced observer, "investors are not like chickens that can be gathered in New York, packed in crates, and shipped to Cairo. They are more like seeds that one must carefully tend--perhaps for years--before any results can be expected."

A combination of factors led to the growth of unrealistic expectations. In Cairo, there appeared to be an insufficient understanding of the increasing levels of competition from other developing countries to attract increasingly scarce investment resources. On the issue of whether or not to provide fiscal incentives, the prevailing attitude evident from numerous interviews seems to have been the following: "Why should we pay investors _anything_ (e.g., through grants or subsidies) when they are here just to make money? We want them to bring us money, not to take our money! Besides, they will come to us anyway."

Unwarranted expectations were further fueled by misleading coverage of investment developments in the Egyptian press, which received information from government sources. In certain cases when investors would come to Egypt on exploratory missions, government officials would announce the visit to the press, and present the potential venture as a _fait accompli_, complete with projected employment and production estimates, rather than as a potential project in a very preliminary stage. Following such coverage, which often dampened the interest of the investor, the New York office would often be called on to complete the near impossible task of concluding the deal.

The viability and expectations of the New York office were also affected by unrealistic calculations of the cost of operations. Whereas certain ministries with overseas offices reportedly maintain confidential books _vis a vis_ Cairo, line by line expenses of the New York investment office were readily available to Cairo-based officials. This gave rise to such inappropriate comparisons as noting that the New York utility bill exceeded the salary of an Under-secretary in Cairo, or that the rent for the New York director's apartment exceeded the salary of the Prime Minister. In sum, the high level of expense inherent in maintaining a New York office and the lead time necessary to bear fruits from such expenses before results are produced were apparently not sufficiently appreciated in Cairo.

<u>Other Coordination Problems</u>

When the New York office was finally closed in 1980, its responsibilities for disseminating information and responding to investor inquiries were transferred to the Commercial Section of the Egyptian Embassy in Washington. However, no additional funds were made available to the Commercial Section to cover its expenses in conducting such activities. For example, if the commercial officer, who reports to the Foreign Ministry, received a request to address a conference of potential investors outside of the Washington area, the individual would have to make a special request for funds from the Investment Ministry. If the funds were approved, they would include only transportation expenses and would not cover living expenses. As a result of such difficulties, the closing of the New York office effectively ended Egypt's active investment promotion presence in the United States.

Lack of coordination among the government bodies involved in promoting investment has also resulted in duplication of efforts and waste of resources. For example, at the same time that the Ministry of Investment commissioned Chase Manhattan Bank to prepare a report on constraints to investment, the Ministry of Economy also commissioned a Washington-based consulting organization to conduct a study of the experience of U.S. business in Egypt. Both studies involved interviews with U.S. firms operating in Egypt. The two studies were published within eight days of each other in March, 1983, addressed the same questions, and came to the same basic conclusions. As another example, the Investment Promotion section of the Investment Authority is ostensibly responsible for the preparation and dissemination of all investment promotional materials. However, without informing the Investment Promotion section, the Ministry of Information has regularly published special advertising sections in foreign business periodicals.[8] Greater inter-ministerial coordination and clearer lines of responsibility could eliminate such duplicative efforts.

V. OTHER PROMOTIONAL EFFORTS

Private Sector Feasibility Studies (PSFS)

Funded in 1979 by a $5 million grant from the U.S. Agency for International Development (USAID) to the General Authority for Investment and Free Zones, this program aims to increase the amount of information available to potential investors through a sequence of activities:

Sectoral studies: The purpose of this program component was to develop and disseminate information on ten selected industries in order to stimulate investor interest in conducting more extensive studies. The industries include food crop production and processing; meat, poultry, and fish production and processing; health care products and equipment; construction materials, components and systems; non-electrical machinery; integrated agribusiness; non-food chemical process industries; automotive components; electrical and electronic machinery; and maintenance and repair facilities.

Roughly $1 million of the $5 million program total was devoted to these studies. The ten sectoral studies were conducted between February 1982 and February 1983 jointly by the Investment Authority and Chase Trade Information Corporation. A U.S. direct mail campaign announced the availability of the completed studies to potential U.S. investors, and by September 1983 a total of 56 U.S. firms had applied to participate in the next phase of the program, a cost-sharing effort for company-specific feasibility studies and reconnaissance visits by interested U.S. firms.

Cost-sharing program: These activities account for $3.6 million of the total budget allocated for the PSFS program. They represent an adjunct to the ten sectoral studies because they encourage firms whose interests have been piqued by the general studies to undertake the next logical step--carrying out their own company-specific preinvestment studies.

For firms in the Fortune 1000, up to 50 percent of costs incurred for the studies are reimbursible, up to a maximum of $200,000. For firms smaller than those in the Fortune 1000, up to 75 percent of such costs are reimbursible, and in addition, 100 percent of direct costs for short visits to Egypt (to a maximum of $6,000) are also reimbursible.

As of September 1983, 56 applications for subsidized preinvestment studies and visits had been received by the Investment Authority. Eighteen had been approved, at least twenty had been disapproved, and the remainder were under consideration. The Investment Authority intends to expand the number of fundable preinvestment studies and reconnaissance visits beyond the originally projected level of twenty each.

Technical assistance and training in the Investment Authority: The remaining funds in the PSFS program--$400,000--were allocated for technical assistance and training to assist the Investment Authority in the implementation of the project and in improving its ability to attract foreign investment. In part, this took the form of training seven Egyptians to help prepare the sectoral studies and to evaluate incoming applications for preinvestment studies and visits.

Although none of the approved studies has yet culminated in an investment, the first feasibility study was not approved until the third quarter of 1982. Several studies are currently underway, and the lead time from study approval to actual investment is considerable. Therefore, it is too early to reach any final conclusions on the effectiveness of the program. However, several observations on the progress of the program are worth noting.

To date, there has been insufficient screening of the applying companies to determine the level and legitimacy of their interest. The Investment Authority's ability to screen applicant companies seems to be hampered by the lack of a presence in the United States, poor coordination with the Egyptian Embassy in Washington, and lack of funds to generate profiles of applicant companies. In some cases it is clear that companies have simply conducted a perfunctory preinvestment study for an investment never seriously contemplated, in which researchers might have been paid 25 percent by the company and 75 percent by the Private Sector Feasibility

Studies Program. Such abuses could be routed out by a better screening mechanism.

In addition, the promotional component of the program should be revived. The U.S.-based direct mail campaign was a one-time effort, and the Ministry is not currently advertising the existence of the program.

The following account of an investor's actual experience with the Private Sector Feasibility Studies program is instructive. A construction materials company familiar with Egypt was considering the possibility of investing in a manufacturing plant to produce locally rather than exporting to Egypt. In the course of their deliberations, they received notice in the mail from the Chase Trade Information Group that a survey of the construction materials sector in Egypt was available, and that there was a possibility of having USAID bear part of the cost of a company-specific preinvestment study. Company officials claimed that the possibility of partial external funding whetted their interest.

The company responded to the Chase letter and requested more information. After receiving the full copy of the sectoral study, they then submited an application to the Egyptian Investment Authority. Having submitted their application, they were visited by a delegation from the Investment Authority and several Chase representatives.

The company was accepted into the feasibility studies program, but withdrew from the program without implementing its proposed investment. First, the company concluded that actually conducting the study as originally proposed would have been a waste of time and resources, since others had already done the work that they had been planning to do in their feasibility study. Therefore, the company simply bought the information from another group and supplemented it with data from the sectoral study and from internally generated research.

The company had finally decided to proceed with the investment when it was informed that it was to be divested by the parent company. This exogenous development caused the investment plan to be dropped from any further consideration. In sum, even though the company had utilized the program with apparent success, the efforts undertaken came to naught.

The Telemission

Under the auspices and funding of OPIC, a satellite hookup between Egypt and 600 potential investors in Boston, New York, Chicago, Minneapolis, San Francisco and Los Angeles was arranged in April, 1982. Local banking establishments acted as hosts. Egyptian President Hosni Mubarak and President Reagan made taped appearances.

Through satellite television technology, Egyptian officials and potential investors met for two hours "face to face." Without travelling to Egypt the participating business officials in San Francisco, for example, were able to meet with the Egyptians by gathering on the 51st floor of the Bank of America Building.

The discussion was moderated in New York by Walter Cronkite. In all, OPIC estmiates that the costs of the telemission totalled $250,000. In each of the six cities, the host financial institution paid $10,000 to become involved in the program. The six banks took responsibility for gathering potential investors.

No new investments have been directly attributed to the telemission exercise. Its proponents claim it was a technical and logistical success which demonstrated Egypt's dedication to attracting new investment. Others suggest that a simpler and less costly mechanism for effectively distributing brochures and promotional material would have been in order prior to engaging in a one-time, logistically difficult and expensive exercise such as the telemission.

Private Investment Encouragement (PIE) Fund

The PIE Fund was a USAID-sponsored, $33 million fund initiated in September, 1979, to provide concessional loans for equity and working capital to Egyptian and U.S.-Egyptian joint venture private enterprises. A semi-autonomous Egyptian government organization was created to administer the project and channel the funds to participating banks. Beyond that, little progress was made. According to GAO auditors:

> It took the Egyptian Government nearly nine months to estabish the Fund organization, and an additional nine months to appoint an executive director. As of April 1982, the Fund had not developed the necessary policies and guidelines for administering the monies or provided adequate staff. AID voiced its concern to GOE, the problems were not resolved, and in April 1982 AID suspended further fund commitments.[9]

The PIE fund remains inactive and the likelihood of it being revived is still unclear. According to USAID officials, the essential problem stemmed from a faulty project design, which required the creation of a new organization rather than the utilization of an existing body. Given the historical inadequacy of the Egyptian institutional support provided to USAID projects, mission officials argued that it was a mistake to try to create a new organization.[10] Ministry of Investment officials attribute the PIE Fund's failure to mismanagement.

Private Sector Activities

The Egypt-U.S. Business Council Investment Promotion Office was opened in Cairo in 1981 with the objective of assisting U.S. business officials in identifying suitable investment projects and suitable joint venture partners, as well as to provide information and assistance to U.S. firms. Financed primarily by USAID, the office's level of activity was scaled down significantly in 1982 due to the departure of the American advisor assigned to the project. A new director has been selected, and the office is currently engaged in the promotion of individual sectors; currently construction--via conferences, dissemination of informational material and development of lists of potential joint venture partners.

Other activities of the Egypt-U.S. Business Council include semi-annual meetings involving the Council's 100 American and 70 Egyptian members. These meetings alternate in location between Egypt and the United

States. The Council also prepares reports on foreign investment in Egypt for the Egyptian government to use in the revision of investment laws, and holds seminars and develops abstracts for projects of potential interest to foreign investors.

The Egypt-American Chamber of Commerce conducts a program involving publications, seminars, and advice and assistance offered to those interested in trade, investment and other business opportunities. The Chamber also prepares and disseminates current information on economic trends and laws, as does the separate American Chamber of Commerce in Egypt.

VI. INVESTMENT RESULTS

It is not surprising, in view of the relatively unattractive investment climate and the problems noted above, that the amount and scope of foreign investment obtained since 1974 has been less than originally anticipated and desired. Under Public Law 43, the Investment Authority has approved 1,654 projects inland and in the free zones, with a total capital of 7.1 billion Egyptian Pounds (about $8.6 billion). However, the total value of actual commitments is well below this figure. In addition, most major investments have been in the petroleum sector.

In 1981, foreign direct investment in Egypt amounted to about $1 billion, three quarters of which was in petroleum and related fields. U.S. Embassy figures indicate that only 24 American companies are currently engaged in joint venture investments under Public Law 43. Twelve ventures are in the industrial and agricultural fields, with total capital of approximately $55 million. Eleven are in banking, consultancy and other services. In addition to these firms, twelve joint venture investments are operating under different laws or special arrangements.

Egypt-American Joint Ventures[11]

	P.L. 43	Other Arrangements	Total
Industry & Agriculture	12	3	15
Petroleum	1	5	6
Banking	5	0	5
Services	6	4	10
Total	24	12	36

VII. RECENT DEVELOPMENTS AND IMPROVEMENTS

The numerous problems noted in this report have not gone unnoticed by Egyptian officials. Over the past year, investment promotion activities have been cut back as attempts to improve the promotional and approval systems are made. Currently, there is a notable lack of any ongoing significant and sustained promotional activity.

The commercial offices of Egyptian Embassies are ostensibly conducting promotional programs, but due to lack of funds, activities are minimal. In Egypt, the Investment Ministry undertakes very little in the way of information dissemination or investor services. The publications it produces are available only at its office in Nasr City, remotely located outside of Cairo, and there is no discernible mechanism by which investors are routinely assisted during their visits to Egypt. The Private Sector Feasibility Studies Program is still being administered but is not actively promoted. The Minister of Investment has, however, particiapted in several investment conferences in Europe and the United States over the past year.

This low level of promotional activity is intentional, according to internal documents of the Investment Ministry as well as public and private statements made by the Minister Wagih Shindy.[12] The Ministry has placed promotion as the last of five items on the agenda outlined by Minister Shindy. To date the Ministry has progressed only to the fourth of the following five items.

1. Putting the house in order.

2. Establishing a system of operation.

3. Specifying periods for approvals of projects.

4. Assembling a plan and an investment map for Egypt.

5. Promoting investments actively rather than passively.

Although it is still too early to reach any conclusions as to achievements, there are a number of indications that progress has been made in implementing this agenda.

Putting the House in Order

In December, 1982, the Investment Ministry commissioned Chase National Bank (in cooperation with the U.S. Embassy in Cairo and Chase Manhattan Bank's Trade Advisory Services Group) to identify the fifteen most illustrative cases of deferred investment plans, and the constraints on those prospective investments. The report was published in March, 1983, and a forum to discuss its findings was held in May. Undertaking "self-evaluations" of this sort has served as a basis for a number of reforms.

In another corrective step, Minister of Investment Shindy eliminated some 300 positions in the overstaffed Ministry, bringing its staff size down to 1,200. This action is a reversal of past policies, in which previous ministers each increased the payroll by 200-300.

Establishing a System of Operation

Efforts to streamline investment-related government operations have stemmed from the almost unanimous conclusion among investors that dealing with the bureaucracy ranks as the most pressing constraint to investment. An approval system designed to alleviate this problem has been in operation since January, 1983. It consists of three groups which meet regularly to consider investment applications.

The Technical Committee meets three times per week. It is composed of three general directors from the Investment Authority who represent the Ministries of Industry, Agriculture and Finance. The committee's responsibility is to determine the completeness of any investment application within 48 hours of its receipt. If the application is judged incomplete, the applicant is so notified within 48 hours. Those judged complete are then sent to the Joint Committee for substantive review.

The Joint Committee meets once a week, or more often if necessary, to recommend approval or disapproval of applications. The Joint Committee consists of representatives of the Ministries of Industry, Agriculture, Planning, Electricity, Housing, Tourism, and other ministries of standing. As previously noted, only a majority vote is required for recommending approval of an application. The Joint Committee forwards its recommendations to the Board of Directors.

The Board of Directors meets on a regular basis according to the number of applications fully completed and approved. The Board's composition is the same as that of the Joint Committee. The Board renders final judgement on investment applications. This system was designed to address the problems of delays and sequential requests to investors for further information, the need to secure approvals from a wide variety of ministries, and the effective veto power previously held by individual ministries.

Specifying Periods for Approvals

On May 1, 1983, a rule was established requiring that a reply must be given to an applying investor within four months of the submission of a complete application. Current indications suggest that progress has been made. Data from the Ministry of Investment shows that in September, 1982, some 327 projects were under consideration, some of which had received no decision for years. With the September, 1983 meeting of the Board of Directors, the last of the backlog was disposed of. Furthermore, the percentage of approved projects actually implemented has risen from 40 percent in September, 1982, to 51 percent in June, 1983. The investment constraints study conducted by Chase noted that progress has been made in expediting approvals. The SRI project team discovered that in some cases, investors expecting long delays had their applications approved so quickly that they had to move rapidly to secure equity to implement their projects.

Assembling a Plan and an Investment Map for Egypt

The process of developing an investment plan for Egypt is currently underway. The Ministry of Investment has requested each relevant ministry to submit a "menu" of investments desired. Each request is treated in detail, including total capital, form of production, employment levels, and other factors. Several ministries have already presented their "menus" to the Ministry of Investment. The latter is in turn compiling an index of requested investments. This index would serve two purposes. It would enable the Investment Ministry to plan its next stage of activity, and it would inform potential investors of opportunities encouraged by the government, thereby addressing the complaints of some investors concerning "unclear priorities."

Active Investment Promotion

As noted above, the Investment Ministry has over the course of the past year focused its efforts on developing a more streamlined investment application review and approval process, and on defining investment priorities more clearly. As a result, few promotion activities have been undertaken. However, a number of programs and projects are now under active consideration and are noted below.

As mentioned earlier, the current Investment Information Center is located in the relatively distant Nasr City area on the outskirts of Cairo, which helps explain why it is infrequently visited by prospective investors. Plans for a more active and ambitious center have been prepared for the Investment Ministry and USAID, which has been studying the design and financing of a comprehensive information promotion center since 1981. The plan is based in part on work by Arthur D. Little and the Industrial Development Authority of Ireland. The Arthur D. Little report recommends consideration of the following basic and comprehensive options, at a cost of up to $25 million.

Investment Center Options

	Basic	Comprehensive
Units	Information Services Regional Offices	Information Services Regional Offices Promotion Foreign Offices Investor Services
Staff	45 (33 in Cairo) (After 5 Years)	121 (85 in Cairo) (After 5 Years)
Space in Cairo	800 m^2	2000 m^2
Cost	$850,000 Capital Costs $2,300,000 Annual Operating Costs by year 4	$1,900,000 Capital Costs $5,100,000 Annual Operating Costs by year 4
Orientation	Basically Responsive	Substantial increases in Initiative

The Industrial Development Authority proposal calls for a less ambitious level of activity involving a three year sequential program limited to thirty employees and a total cost of $500,000.

It is likely that one of these two plans will soon be implemented. New promotional material describing changes made during the past year is currently being commissioned by the Investment Authority, and time-specific charts on goals to be reached are now being prepared.

The new Investment Information Center is likely to be vested with responsibility to respond to investor inquiries, to prepare information on investment opportunities and business conditions, to identify and pursue potential investors actively, and to provide ongoing services to prospective and established investors. This range of activities represents a significant expansion of current efforts.

U.S. Business Promotion Center

The Investment Authority's activities will be coordinated and complemented by those of the soon-to-be established U.S. Business Promotion Center, funded by USAID. This center will be separated organizationally from the Investment Authority, USAID, and the Egypt-U.S. Business Council, but its activities will be overseen by representatives from those three organizations. The goal of the office will be to identify market opportunities in Egypt and to seek U.S. and Egyptian investors. The mandate of the office is to provide services tailored to the specific short term needs of corporate personnel visiting Egypt. The underlying philosophy is to complement activities carried out by the Egyptian government.[15] Should the center succeed in providing such services, it would fill one of the major gaps in the current system.

Private Sector Feasibility Studies Project

The forthcoming promotion offensive will in all likelihood involve a renewed emphasis on the multifaceted PSFS program. The program staff is currently receiving, reviewing, and approving applications, despite the fact that the program is not being actively advertised and the cost-sharing component for preinvestment studies reportedly will be emphasized by both the Investment Authority and the prospective U.S. Business Promotion Office.

VIII. CONCLUSIONS

As this report makes clear, Egypt labors under a very negative image of its investment climate as a result of several factors: Egypt's location in a troubled region of the world; the vestiges of its socialist past and anti-private enterprise orientation; its lethargic and unresponsive bureaucracy; and various other official and unofficial investment disincentives. In light of these negative factors, it is not surprising that the Open Door policies of the last ten years have yielded disappointing results. One should not have expected, under these circumstances, success from past promotion efforts, even if they had been better-planned and executed.

The SRI project team, however, did observe the beginnings of certain improvements in the Egyptian government's management of investment-related issues. In addition, with the assistance of the USAID mission, a number of innovative programs have been initiated and may help turn the tide in Egypt. Nevertheless, the international competition for foreign capital is so intense that major new volumes of investment capital will not likely flow to Egypt unless substantially more progress is made in improving the country's investment conditions.

For the present, considerably more emphasis could fruitfully be put on promoting indigenous investment in order to improve economic performance and create a more receptive national consciousness to a free enterprise economy. To support this move, various promotion techniques should be employed domestically in tandem with highly targeted and professionally-staffed overseas activities. Over time, such mutually reinforcing domestic and foreign investment promotion activities might well help vindicate this country's ambitious economic redirection initiated over ten years ago.

FOOTNOTES

1. General Authority for Investment and Free Zones, "The Official Guide to Investment in Egypt," June 1982.

2. A.D. Little International, "Investment Information Center-updated Project Plan," July 1981.

3. U.S. General Accounting Office, "Lessons Learned from AID's Private Sector Development Efforts in Egypt," GAO/ID-83-18, February 28, 1983, (Hereafter cited as GAO Report).

4. Chase National Bank, "Investment Constraints Report," March 16, 1983, (hereafter cited as Investment Constraints Report).

5. Reckford International, "U.S. Investor Experience in Egypt," March 8, 1983, and Chase National Bank, op. cit.

6. Investment Constraints Report.

7. Ibid.

8. Ministry of Information advertising includes a 20-page color section in Nation's Business in 1981, 1982 and 1983.

9. GAO Report.

10. Ibid.

11. Compiled from "U.S. Companies in Egypt," U.S. Department of Commerce, Foreign Commercial Service.

12. Ministry of Investment and International Cooperation, "New Policies to Stimulate Investment Activity in Egypt," March, 1983.

13. Industrial Development Authority of Ireland, "The Investment Center: A Practical Approach," July 8, 1982.

14. Egypt-U.S. Business Council, Joint Executive Committee, "Continuation of U.S. Investment Office: Program Description and Scope of Work," November 1982.

COSTA RICA

Table of Contents

I. INTRODUCTION: THE HISTORICAL HERITAGE

In contrast to its Central American neighbors, Costa Rica has maintained a long-standing democratic tradition, which has resulted in enviable political calm and, until recently, has fostered considerable economic progress. Despite its name, which means, "rich coast" in Spanish, no significant exploitable mineral wealth was discovered in Costa Rica by the Spanish explorers. Paradoxically, this proved to be an asset inasmuch as the Spanish conquistadors ignored Costa Rica, allowing it to evolve into an egalitarian system of small landholders. With a very small indigenous Indian population (about 25,000), the predominantly Spanish settlers produced an ethnically and linguistically homogenous population.

The introduction of the coffee-growing industry in the early 19th century, and banana cultivation in the late 19th century, reduced Costa Rica's isolation and opened important new sources of wealth. While class differences began to emerge as some Costa Ricans accumulated large fortunes, the earlier social and political attitudes prevailed to create a large middle-class. A relatively even income distribution combined with political stability help characterize Costa Rican development and its attractiveness to investors.

Unlike its neighbors, only two significant interruptions in constitutional government have occurred since 1889: a 30-month dictatorship beginning in 1917, and the revolution of 1948, which resulted in the creation of the government structure underlying the modern Costa Rican economy. The revolution, led by the socialist Jose Figueres Ferrer, was precipitated by the legislative annulment of a disputed presidential election. In the wake of the revolution, during 18 months of rule by a government junta, many social and economic reforms were instituted and culminated in the adoption of the present Constitution.

Reflecting the country's social attitudes, the Constitution abolished the military and set the framework for generous social welfare programs, particularly in health and education. Costa Rica's skilled and educated labor force is often considered its single most important factor endowment.

While these equity-oriented policies have led to the development of a strong social and physical infrastructure and a highly-educated population, they have also become a major and continuous drain on government resources.

The new Constitution made the state the dominant economic unit by "nationalizing" the banking system and assigning control of the production and marketing of the national crop--coffee--to the Oficina del Cafe, a government organization. Costa Rica has attempted since the 1960s to diversity its agricultural base through the intermittent provision of subsidies aimed at lowering its dependence on coffee, which in 1950 accounted for 90 percent of all exports. Subsidized production credits have resulted in coffee production becoming for the most part a nationally-owned industry. However, cultivation of the second most important export crop--bananas--largely has been controlled by foreign interests such as United Brands and Standard Fruit. Nevertheless, small investments characterize the limited foreign investment of the 1950s.

In the 1960s, the government initiated an industrial policy based on import substitution, which was advanced significantly by the creation of the Central American Common Market (CACM). The CACM stimulated both indigenous and foreign investment by increasing the size of the market for Costa Rican producers. This development strategy resulted in a positive macroeconomic performance until 1977, when GDP growth reached a high of 7.7 percent. Over time, however, the neglect of the traditional export-oriented agricultural sector and the negative long term effects of import substitution policies began to exact a toll on the economy. When negative external factors, such as falling export prices, higher import prices, and the growing political unrest and economic instability in the rest of Central America, converged in the late 1970s, Costa Rica's forward momentum was reversed. Average annual GDP growth plummeted from the 1977 high of 7.7 percent to an estimated 6.0 percent decline in GDP in 1982.

While the rise in oil prices contributed to the growing economic crisis, ballooning external debt obtained to finance increased public spending was the principal cause. To cover the worsening current account deficit, the former government led by President Rodrigo Carazo escalated government borrowing in 1979 by 300 percent. External debt servicing, which rose from 10 percent of total exports in the mid-1970s to over 25 percent in 1980, continues to exert enormous pressure on the economy. The current Administration of President Luis Alberto Monge has enacted certain austerity measures, such as reducing various government subsidies and devaluing the colon, but has not made the budget cuts needed to reduce the public sector deficit sufficiently. With virtually no domestic capital available for new investments, the Monge Administration is looking to foreign investment as the spark to revitalize the private sector, increase exports and provide foreign exchange earnings.

II. INVESTMENT POLICIES

Costa Rica followed an import substitution-based industrial policy that yielded considerable economic growth until 1977. This economic success, as well as the dramatic rise in foreign investment in the 1960s, was due in large part to Costa Rica's participation in the CACM.

A. Central American Common Market (CACM)

The Central American Common Market (CACM), composed of Costa Rica, El Salvador, Guatemala, Honduras (which withdrew from membership in 1970), and Nicaragua, was established in 1960 under the General Treaty for Central American Integration. During its early years, from 1961 to 1969, CACM offered the promise of becoming a textbook model of integration among small-market, low-income economies. However, regional political instability and worldwide economic problems have crippled its effectiveness in recent years. Under the treaty provisions, Costa Rica's industries were not only able to develop behind a protective wall, but also within an enlarged free trade market area. While the integration scheme promoted specialization according to comparative advantage, Costa Rica was able to gain the most benefits from the CACM given its relatively advanced economic base. The impact of the establishment of the CACM is apparent in the 14-fold expansion of Costa Rican exports to the region between 1960 and 1968. Costa Rica's exports of manufactured products to the CACM increased from $2.4 million in 1960 to $33.6 million in 1968, for an average annual growth of 39 percent.

Among the "dynamic" effects of Central American integration were the expansion of real investment to take advantage of the expanded market, and the increased availability of investment funds. Private investment grew at an average annual rate of 6.9 percent between 1960 and 1968. In constant 1960 U.S. dollars, private investment almost doubled between 1960 ($66.3 million) and 1968 ($112.7 million). A significant portion of new private investment was from foreign sources. Private net capital inflows grew from $8.1 million prior to CACM creation, to $60.6 million in 1970, amounting to an average growth rate of 22.3 percent per year.

Until 1968, the Costa Rican government's primary investment policies were those agreed to under the CACM General Treaty, specifically the Central American Agreement on Fiscal Incentives for Industrial Development. This agreement grants certain fiscal benefits to new or expanded manufacturing industries which contribute in an effective manner to the economic development of Central America. However, the following industries were to be governed by national laws rather than uniform incentives: mining, oil and gas drilling, lumbering, fishing, service industries, agricultural activities, and housing construction. As in the 1950s, investment activity in the 1960s was based on the attractions of political stability, the availability of skilled labor, and the creation of the CACM, rather than as a result of any investment promotion effort. However, a number of government activities such as price controls and subsidized credit did indirectly promote industrialization and the creation of capital intensive production methods.

B. Center for Promotion of Exports and Investments (CENPRO)

As a result of the slowdown in CACM-generated trade and investment in the late 1960s, the Costa Rican government in 1968 initiated an investment promotion policy by creating the Center for the Promotion of Exports and Investments (CENPRO). CENPRO was established to expand non-traditional exports and promote foreign investment with a broad mandate for formulating policy recommendations and providing a wide range of support services to potential exporters and investors. Created by Law No. 4081 on March 2, 1968, CENPRO's two major export and investment promotion activities are described below:

Export Promotion:

a. Identify new products with export potential.

b. Devise programs which develop production of exportable products in relation to the investment program.

c. Identify local problems related to exports.

d. Investigate new markets for Costa Rican exports.

e. Evaluate the industrial export capacity.

f. Provide information regarding procedures and other requirements affecting imports in other countries.

g. Conduct an intensive export training program in conjunction with assistance provided by international organizations.

h. Provide technical assistance to the exporting sector.

i. Recommend incentives to exports outside the Central American area, such as subsidies, allowances and certain tax exemptions.

j. Provide commercial contacts between foreign importers and Costa Rican producers.

k. Provide coordination and advice on the organization of missions and participation in international fairs.

Investment Promotion:

a. Identify industrial and agricultural investment opportunities, geared principally to new exportable production lines or import substitution production that represents foreign exchange savings.

b. Recommend measures and incentives to encourage capital investment, taking into account related regional treaties.

c. Make available existing studies on investment opportunities.

d. Recommend to the corresponding authorities the granting of Investor Visas.

A semi-autonomous agency, CENPRO operates under the responsibility of a Board of Directors, which includes the Ministers of Economics, Agriculture and Livestock Production, and Foreign Relations, the Director of the Office of Planning, the Manager of the Central Bank, the Executive Director of CENPRO, and a representative from each of the Chambers of Agriculture, Commerce, and Industries. CENPRO functions under the Ministry of Economics, Industry and Commerce, whose Minister is to preside over CENPRO's Board of Directors. In addition, CENPRO is served by an Advisory Group which includes representatives from: the Chambers of Agriculture, Industry, Commerce, Livestock Production, Cocoa, Banana, Sugar, Coffee, Fisheries; the National Board of Production; commercial banks; the Office of Coffee; the Sugar Cane Coalition; and the Federation of Workers.

Despite its dual charter, CENPRO has only actively promoted exports, neglecting its mandated investment promotion functions. The only investment promotion function CENPRO undertakes is passive, i.e., offering information and assistance to potential investors who came to CENPRO seeking help. This passive orientation is reflected in a CENPRO pamphlet entitled "What Does the Centre Do For You? Contact us!" The CENPRO literature states that it also makes available the following kinds of investment information:

- Furnishes information encouraging investments in the country.

- Supplies information regarding facilities, regulations, and the investment climate in Costa Rica; rendering technical assistance at various stages that require approval for industrial projects.

- Advises regarding incentives, facilities, and procedures for the installation of drawback industries in the country.

- Evalutes the projects or investments of interest.

Costa Rica's import-substitution policies and local manufacturers' preference for intraregional trade notwithstanding, the external export promotion objective behind CENPRO was reached as worldwide exports increased. While the 1960s witnessed rapid growth for intraregional exports, Costa Rica's exports to the rest of the world expanded significantly in the 1970s. Costa Rica's worldwide exports (excluding CACM) of manufactured products rose from only $2.5 million in 1969 to $22.3 million by 1975, and to $80.3 million by 1981. Much of this increase was due less to CENPRO's promotional efforts than to the dramatic improvement in Costa Rica's business environment. In fact, CENPRO has been criticized for lacking influence in the government, failure to undertake focused or targeted activities and sector specialization, and ignoring investment promotion. In addition, the overseas offices of CENPRO, with the exception of the Puerto Rico office, have been criticized as "ineffective and wasteful" by exporters surveyed for an Arthur D. Little assessment of CENPRO activities.[1]

CENPRO opened overseas offices during the 1970s in the U.S. cities of Miami, New Orleans, New York and San Francisco, in Panama, Puerto Rico, Japan and in several European cities. The staff of most of these offices often had no previous business experience, and frequently were political appointees. As Costa Rica's economic problems worsened in the late 1970s and early 1980s, most of the overseas CENPRO offices were closed, and the country's embassies or consulates were asked to act as ad hoc promoters. The Monge Administration closed the remaining offices in Miami, Panama, and Puerto Rico immediately after taking office.

C. Export Promotion Act

In late 1972, the Costa Rican government enacted the Export Promotion Act (No. 5162) as part of a major effort to increase exports and, indirectly, to encourage investment. The law offered prospective exporters the benefits of a Tax Credit Certificate (CAT) equal to a 12-15 percent tax exemption for up to ten years, or a 4-10 percent tax exemption through issuance of a Certificate of Increased Exports (CIEX). Exporters meeting the following criteria were eligible for these incentives:

a. The exports in question must be of a non-traditional nature.

b. They must be exported to third markets, or to those markets with whom no Free Trade Agreements are in effect.

c. The national value-added of the merchandise shall be of at least 35 percent.

d. Individuals applying for these benefits must be either Costa Ricans or foreigners who have been in possession of a Residence Card for over 5 years.

e. Any company must have at least 60 percent Costa Rican capital.

The law also provides a ten-year exemption from or reimbursement of import taxes on machinery, equipment and raw materials used for the production of non-traditional exports. In addition, a provision allows temporary imports or "drawbacks" to be imported for a period of not more than twelve months without previous payment of duties on the following products.

a. Raw materials.

b. Unfinished products.

c. Finished products which become components of other finished products manufactured, produced or assembled in the Country.

d. Containers or packaging materials.

e. Molds, dies, spare parts, tools and other services, when they serve as complements to other apparatus, machinery or equipment destined for export, as well as labels and tags used by exporting firms. These products must be incorporated into goods produced, manufactured or assembled in the country and destined for export to countries outside of Central America.

CENPRO's Exporter Services Division reviews the CAT applications and makes recommendations to its Board of Directors. New or difficult applications are referred to a joint ad hoc committee made up of Ministers from the Board prior to placement before the full Board.

D. Costa Rican Development Corporation (CODESA)

Direct government involvement in manufacturing activities had been minimal until the Costa Rican Development Corporation (CODESA) was formed in 1974. Initially, CODESA was intended to apply its resources to joint ventures with private entrepreneurs, eventually backing out of the investments. However, CODESA entered fields with low rates of return which investors avoided. These included gasohol and aluminum production, urban bus transport, and cement and fertilizer production. In addition, the previously nationalized railroad and oil refinery have been placed under CODESA's control. Consequently, CODESA has become a holding company for largely unprofitable ventures, and runs a significant annual deficit.

E. Export Processing Zones

In late 1981, the Costa Rican government enacted the Export Processing Zone and Industrial Park Act (No. 6695), commonly called "Zonas Francas," to attract investment in drawback industries. One zone was opened on the Caribbean near the port of Limon, with an additional zone planned for Puntarenas on the Pacific. These zones are non-residential areas where companies that handle, process or manufacture goods to be exported from Costa Rica can receive special incentives. These incentives include total exemption from all custom duties and other related taxes on the import of raw materials, manufactured or semi-manufactured products, components, parts, packing materials as well as machinery and equipment, molds, dyes, etc. They also include total exemption from all duties and export taxes, as well as from taxes on capital and net assets for a period of ten years. The results of the Zonas Francas thus far reportedly are disappointing for a variety of reasons which include the exorbitant freight transportation costs to and from those very remote sites.

III. THE CURRENT STRUCTURE FOR INVESTMENT PROMOTION

The Monge Administration took office in mid-1982 at the height of Costa Rica's economic crisis, and seemed prepared to take those austerity measures necessary to restore stability. The government understood that substantially increased export earnings were required to service its enormous foreign debt. The Monge Administration argued that the "principal impulse should be from the private sector." The lack of domestic capital caused by capital flight prior to the devaluation of the colon has forced the government to seek foreign capital inflows for investment. The government hopes the recently enacted Caribbean Basin Initiative (CBI) will provide market opportunities for its products. CENPRO's passive, export-oriented structure has been judged inadequate to meet Costa Rica's new investment promotion needs. Therefore, in February of 1983 the Ministry of Investments and Exports (MINEX) was created by Presidential decree.

A. The Legal Institutional/Framework

As readily acknowledged, Costa Rica's investment policy and promotion structure are currently in a state of transition. As a result, in certain cases changes in laws have not caught up with actual policies and practices. Since MINEX was created by Presidential decree rather than legislative action, it is not legally afforded the same status as cabinet ministries. In practice, however, the Minister of Investments and Exports is reported to have at least as much influence as do cabinet members. Furthermore, no legal relationship exists between MINEX and CENPRO, even though MINEX is charged with formulating policy which CENPRO will implement. In addition, while Costa Rican law stipulates that the Minister of Economics, Industry and Commerce is to preside over CENPRO's Board of Directors, under current practice the Minister of Investments and Exports fills that role.

These fluid institutional relationships prompt speculation concerning investment policies after the current administration changes in 1986. In general, officials interviewed by the SRI project team asserted that the future of investment policies would depend on the performance of the current Administration in restoring the economy, as well as the performance of MINEX in securing new investments.

The Administration has reportedly delayed seeking a legal mandate for MINEX until it has had an adequate opportunity to develop its programs. Efforts have been undertaken to improve the Costa Rican investment climate, including the elimination of specific disincentives such as the four percent tax on non-traditional exports. Other fiscal changes sought by investors, such as reduction in the 65 percent corporate income tax rate, apparently have not been given priority consideration.

One measure considered to be a major impediment to investment is the "ley de la moneda," the law setting the official exchange rate at 20 colones to the U.S. dollar. (The free market rate is currently 43.6 colones to the U.S. dollar.) Although the official rate is used only for a very limited number of strictly enforced transactions, a Supreme Court action declaring the free rate illegal has worried potential investors. The case is described in the following excerpt from a Harvard Business Review article.[2]

> Its (Costa Rica) government unpegged the currency from its official mooring of 8.6 colones to the dollar in September 1980; the colon reached a level of 14 by year-end. Costa Rica's Supreme Court interceded in mid-1981 with a decision that the floating rate, which by that time was up to 40 colones to the dollar, was illegal. Ignoring the court decision, customs continued to impose duties calculated at the free rate, while the Central Bank offered dollars only at the free rate. The government reneged on its 1980 vow to settle dollar liabilities incurred prior to the colon float at the official rate.

One proposal offered by the business community attempts to address investor concerns about possible investment policy changes through explicit statements of the "rules of the game" in an "Export Contract." While political considerations reportedly have slowed progress on this proposal, efforts are planned to continue working for enactment in 1984.

Government officials have indicated that they have been embarked on a "house-cleaning" exercise aimed at improving the country's investment climate before initiating any aggressive investment promotion programs. As noted previously, certain of the legislative and regulatory changes required have already been undertaken, while others have yet to be acted on.

Nevertheless, the government states that it will soon initiate a more active promotion effort. It is not yet clear how the two government agencies with promotion responsibility--MINEX and CENPRO--will rationalize their activities. In addition, a new and aggressive set of activities promoting the private sector have been undertaken by the Costa Rican Coalition for Development Initiatives (CINDE).

B. <u>Ministry for Investments and Exports (MINEX)</u>

Throughout MINEX's first year of operation, it has worked to redirect government policy from its historical import substitution orientation to one of attracting new external investment in export activities. MINEX has begun to craft plans for various promotion activities to be initiated in 1984. MINEX's policy development and investment promotion role is theoretically coordinated with CENPRO's responsibilities in these areas by virtue of the fact that the current Minister of Investments and Exports also presides over the CENPRO Board. In addition, a few of MINEX's professional staff members are in fact seconded from CENPRO. In recent promotional literature MINEX states that CENPRO is the institution created as a "one-stop investment information center." Nevertheless, little evidence is available of significant MINEX/CENPRO collaboration on promotion.

MINEX's future promotional efforts were foreshadowed in late 1983 by two Costa Rican business opportunity seminars convened in Minneapolis and Miami. These meetings were sponsored by MINEX with technical support from CINDE. The seminars brought together senior Costa Rican government officials (including the President, Minister of Investments and Exports, and Costa Rican Members of Congress), successful Costa Rican investors and prospective U.S. investors for a discussion of investment opportunities in Costa Rica.

Local American organizations were assigned responsibility for identifying and attracting to the meetings prospective U.S. investors. A special 15-minute video documentary on investment opportunities in Costa Rica was produced for use at these meetings.

By most accounts the Miami session elicited more interest among prospective investors than did the Minneapolis meeting. However, it is too early to judge the ultimate impact of these meetings, and no data is available regarding specific meeting objectives and initial results. MINEX plans six to ten additional seminars throughout the U.S. in 1984 targeted to specific industries, coordinated with local chambers of commerce or other appropriate coordinating bodies.

C. Center for Promotion of Exports and Investment (CENPRO)

CENPRO has recently been reorganized in order to respond more effectively to the current Administration's emphasis on investment promotion. In addition, more industry-experienced staff reportedly are being recruited. CENPRO's staff of 68 are divided into six divisions: Drawback/Joint Venture; Agriculture and Agro-Industry; Service to Exporters; Industry and Manufacturing; Investment Identification/Promotion; and Public Relations.

The Investment Identification/Promotion unit's stated purpose is to target potential investors. However, its current plans for 1984 reportedly only include publication and distribution of ten pieces of promotional literature prepared by each of CENPRO's operating divisions.

D. Coalition for Development Initiatives (CINDE)

CINDE, the Costa Rican Coalition for Development Initiatives, is a private association of prominent Costa Ricans founded in late 1982 to help improve the climate for investment, production and exports, as well as to encourage the involvement of private voluntary organizations (PVOs) in cooperatives and small business ventures. The concept for CINDE reportedly derived from widespread dissatisfaction among Costa Rican businessmen concerning government responsiveness to the needs of the private sector. A CINDE organizational proposal was submitted to USAID by various members of the Costa Rican Chambers of Commerce. An initial USAID grant of $11.25 million was authorized to fund CINDE's first two years of operation, concentrating on two basic sets of activities: programs designed to help PVOs address social needs; and programs aimed at promoting production, investment and exports. As part of the latter function, CINDE has initiated a public awareness campaign intended to increase Costa Rican appreciation of the importance of private sector development. Almost two-thirds of CINDE's budget is earmarked for its PVO activities, with the balance allocated to its so-called Promotion, Investments and Exports (PIES) activities. About 20 percent of CINDE's promotion budget reportedly is expended in direct support of MINEX, largely through the production of promotional materials for MINEX's use. For example, CINDE produced the written brochures and audio-visual documentary used by MINEX at its recent Miami and Minneapolis business opportunity seminars.

CINDE works closely with and helps fund the activities of various chambers of commerce as part of CINDE's PIES program. CINDE's "awareness campaign," however, comprises the heart of the PIES promotional activities. This campaign, directed by a prominent former journalist, is intended to generate support for those policy changes aimed at improving the country's investment climate. The campaign has targeted two groups for its initial programming: the press and Costa Rican youth. CINDE seeks to educate the press--through press relations activities and placement of articles, advertisements, and so forth--on what the private sector has to offer Costa Rica. CINDE has also worked to involve the domestic press in MINEX's U.S. seminars so they could appreciate first-hand the concerns prospective investors have regarding their country's investment climate.

In 1984, CINDE will gather teams of young professionals (attorneys, economists, political scientists, etc.) for a series of weekend seminars aimed at discussing the country's economic objectives and the role of the private sector. In addition, CINDE (with the assistance of an advertising agency) will sponsor a competition among school children to encourage national interest in ways to increase the country's exports. CINDE will also televise ten 3-minute documentaries about specific Costa Rican industries as part of the same program. Newspaper advertisements and cartoons will also be run on these issues to raise Costa Rican consciousness of and support for private sector initiatives.

E. Other Organizations

Costa Rica has a well-developed network of business chambers representing all aspects of commercial activity: agriculture, industry, transport, small industries, etc. These chambers reportedly exercise considerable influence on public opinion and policy.

The country also has two important private sector development banks both established with USAID financing. BANEX (the Bank for Exports) was established in 1981 with $2 million of local capital to provide financing for certain non-traditional export-oriented businesses. BANEX was more recently infused with a $10 million concessional loan from USAID.

COFISA (the Costa Rican Corporation for Industrial Finance) was also established with USAID funding 20 years ago to facilitate local industrial financing. While COFISA enjoyed remarkable success in its early years, it has recently been devastated by the currency devaluation. A recent USAID loan of $10 million has helped resuscitate COFISA. The corporation finances diverse projects such as import substitution industries and export-oriented agro-industries. Both BANEX and COFISA limit their involvement in development projects to 30 percent equity participation.

Under the Monge Administration, CODESA is determined to redirect its activities away from 100 percent ownership of large, unprofitable infrastructure ventures to minority equity participation (not to exceed 30 percent) in small rural development projects. CODESA will help finance its new projects with the capital generated through the sale of its position in certain large ventures.

IV. INVESTMENT PROMOTION ACTIVITIES

Since Costa Rica's active quest for new investment--particuarly foreign investment--is in its infancy, so too are its investment promotion programs. Nevertheless, numerous promotion plans, some of them quite ambitious, are currently under consideration.

A. Brochures and Publications

CENPRO's Investment Promotion Division plans to produce ten industrial sector publications in 1984. In order to avoid the problems of poor publication coordination encountered in the past, the Investment Promotion Division has been asked to prepare these publications with the assistance of the other CENPRO operating divisions. Past CENPRO publications have focused almost exclusively on export questions. CENPRO is scheduled to produce a new investors' guide in Spanish and English, with various other publications prepared in French and German. No specific publication distribution plan was available for review.

CINDE plans to produce its own investors' guide in 1984. CINDE publications prepared for use at various U.S. seminars were generally attractive and well-crafted. However, various CENPRO officials complained that these publications were not widely made available for more effective use or review.

In 1984 CINDE will also prepare brief video documentaries to initiate the "awareness campaign" to highlight the ways in which specific industries are increasing exports. CINDE utilizes outside consultants, artists and printers for all of their print and media programs, thereby giving CINDE's products an attractive and professional character.

B. Advertisements

MINEX officials interviewed expressed a reluctance to utilize mass media or advertising techniques for promotional purposes. Generally, they stated that targeted seminars were their preferred promotion activity for

1984. Mass advertising was utilized, however, in 1977 and again in 1983 when various official private entities published a 12-page Newsweek supplement on the Costa Rican economy. According to officials of CODESA, one of the supplement's chief sponsors, the Newsweek advertisement generated numerous fruitful inquiries from prospective investors for various CODESA ventures. Data needed to analyze the cost effectiveness of these techniques was not available.

C. Seminars

As indicated earlier in this report, MINEX's main promotional efforts for 1984 revolve around a series of six to ten business opportunity seminars to be convened in a number of U.S. cities. MINEX officials indicate it is their intention to select the seminar locations based on the industrial character of the area--e.g., an electronics industry seminar in the San Francisco area. More precise investor targeting information was unavailable. It is, however, clearly MINEX's intention to establish and utilize a U.S. office for much of the seminar planning and preparation. While MINEX expressed less than total satisfaction with the preparatory role played by local U.S. Chambers of Commerce in its previous seminars--especially the Minneapolis meeting--some continued coordination with local American organizations was judged probable.

In addition to its seminar programs, MINEX is reportedly seeking to use the influence of prominent U.S. businessmen to help promote investments in Costa Rica.

D. Direct Contacts/Field Office

MINEX states its determination to target prospective investors and aggressively initiate direct contact with them. However, it is unclear precisely what techniques will be utilized other than overseas seminars. CENPRO presumably only will have direct contact with those prospective investors who go to CENPRO seeking information. CINDE will provide MINEX with technical support for its investor contact initiatives--particularly with printed and audio-visual materials.

CINDE will also initiate contact with the foreign press in 1984 in an effort to showcase the country's stable environment and investment potential. To further cultivate the press, CINDE will consider financing foreign press trips to Costa Rica.

MINEX also intends to open a U.S. field office in 1984. Its function is seen primarily as an intelligence gathering center on prospective investors. This "computerized data base" would be used to help target MINEX's activities in the United States. Ministry officials indicate they would anticipate an initial office staff of five, which would coordinate with a similar-sized MINEX staff in San Jose. The specific operating plan or location of the U.S. office was uncertain as of this writing.

V. CONCLUSIONS

Clearly the government of Costa Rica appreciates the urgent need to attract foreign investment capital to revitalize its stalled economy. Nevertheless, a number of the most essential policy adjustments required to improve the country's investment climate have yet to be undertaken. Costa Rica should not expect to attract substantial new investment solely by virtue of its reasonably peaceful environment or through the advantages of the Caribbean Basin Initiative. President Monge recently acknowledged the need to eliminate the country's investment disincentives when he told his people:

> In order to take advantage of the opportunities which are opened to our country by the Caribbean Basin Initiative, in the first months of 1984, we must clearly define the legal standard for promoting national investment and attracting foreign investment, with the objective of increasing export production to the markets outside of Central America. We will eliminate income tax surcharges affecting non-traditional exports to markets outside of Central America. We will eliminate the foreign exchange taxes. We will modify our income tax schedule so that we can compete with other nations.[3]

Until such changes are made, this country's investment promotion activities will likely yield disappointing results.

Those institutional changes needed to rationalize investment policy have been initiated with the formation of MINEX. However, the relationship between MINEX and CENPRO seems to require additional coordination in order to help avoid investor confusion. MINEX and CENPRO this year will reportedly move to one central location in San Jose and establish a "one-stop" investment information office which will offer the prospective investor investment information (e.g., taxes, permits, duties, etc.) only currently available from each ministry involved. Perhaps this shared MINEX/CENPRO facility alone will significantly improve program coordination.

While much criticism was heaped on CENPRO throughout the course of the SRI project team's visit, the fact remains that CENPRO will necessarily have to play a key role in helping to process and facilitate new investment decisions as promotional efforts bear fruit. This is true if for no other reason than the small size of MINEX would preclude the Ministry from being able to handle expeditiously a significant number of investor inquiries. In fact, the current institutional structure raises significant doubt as to whether the government would be able to offer prospective investors the attention they require in order to transform investor interest into positive investment decisions.

While foreign and domestic investors are treated equally under the Costa Rican Constitution, official investment promotion plans currently under discussion seem to focus almost exclusively on foreign investment. Clearly prospective foreign investors will want to observe tangible evidence of the confidence Costa Ricans' themselves have in their own economic revival. Therefore, it would seem that progress at reversing the enormous domestic capital drain could not only generate positive economic activity, but also improve the country's attractiveness to foreign investors.

Finally, Costa Rica is embarked upon an ambitious investment promotion course in a very competitive environment. The country's investment policies clearly are still in transition. How successful it becomes will depend in large measure on how well-planned and implemented each step is in the process.

FOOTNOTES

1. Arthur D. Little International, Inc., "A Diagnostic Assessment of CENPRO and Costa Rica's Exporting Environment, Part I," 1982, pp. I-14 and I-15.

2. Pravin Banker, "You're the best judge of foreign risks," Harvard Business Review, March-April 1983, p. 160.

3. Speech given by President Luis Alberto Monge, "Una Alianza para La Produccion," San Jose, Costa Rica, December 6, 1983.

Section Three

INVESTMENT CLIMATE REVIEW

IRELAND

TAIWAN

JAMAICA

EGYPT

COSTA RICA

IRELAND'S BUSINESS AND INVESTMENT CLIMATE

Introduction

The independent Republic of Ireland occupies five sixths of the island of Ireland, with the remaining area taken up by Northern Ireland. The entire island was ruled by Great Britain until, following several years of violence in Ireland, home rule and dominion status were granted in 1921 to the newly-created "Irish Free State." In the 1930s and 1940s, the Irish Free State gradually increased its independence from Britain. It ended the last of its constitutional ties with Britain in 1949 by declaring itself an independent republic and withdrawing from the Commonwealth. Northern Ireland remains a constituent part of the United Kingdom of Great Britain and Northern Ireland. Although the Republic of Ireland's constitution declares that "the national territory consists of the whole island of Ireland," it limits its application to the area of the Irish Free State, "pending the reintegration of the national territory." The population of the Republic is 95 percent Catholic, while Northern Ireland is two-thirds Protestant.

After the creation of the Irish Free State and until the 1950s, the government sought to encourage the development of domestic industry through a policy of import substitution. This policy was only partly successful, however, and since 1958 the government has concentrated instead on efforts to attract foreign investment through a variety of tax incentives, subsidies, grants, and the establishment of free zones.

Between 1960 and 1981, direct foreign investors committed a total of about 2.5 billion Irish pounds to new industrial ventures in Ireland. Such investment inflows, plus Ireland's entry to the European Community in 1973, contributed to average annual GDP growth rates that were among the highest of the industrialized countries in the 1970s. However, this relatively rapid growth was initiated from a low base, and so Ireland remains among the lesser developed countries of the European Community. Per capita income in 1980 was U.S. $5190, roughly half that of other Northern European countries.

The second round of oil price increases in the late 1970s and a number of other unfavorable external and internal developments led, beginning in 1979, to a slowdown in Ireland's economic growth from which the country has yet to recover. Despite these recent downturns, several factors maintain Ireland's attractiveness to foreign investors: Ireland's stable economic and policy environment; its generous investment incentive packages; a young, skilled, and relatively inexpensive labor force; and proximity and tariff-free access to the European Community.

Ireland's two major parties are the Fianna Fail (80 seats in the 166-seat parliament), headed by Prime Minister Charles Haughey, and the Fine Gael (63 seats), led by Dr. Garrett FitzGerald. Also represented in parliament are Labor (15 seats), the Workers' party (3 seats) and independents (4 seats). The Fianna Fail minority government has been in power since March 1982, following the collapse of the Fine Gael-Labour coalition government. Fianna Fail is generally believed to be supportive of the business community, although this belief has been sorely tested by its decision to raise corporate taxes. The inability of either party to secure a clear majority in parliament has weakened government efforts to address the country's growing economic problems.

Ireland's Domestic Economic Performance

From the 1920s until the 1950s, the government of Ireland followed a policy of import substitution through high tariffs and import quotas. This policy was aimed at increasing Ireland's economic independence and developing domestic industries, which in 1926 employed only 13 percent of the workforce, compared with 53 percent in agriculture. The government also hoped that, by providing industrial employment opportunities, it might stem the flow of emigration which had begun in the nineteenth century and which continued (at a diminishing rate) until as late as the 1960s.

The results of this policy were mixed. Industrial production trebeled between 1926 and 1957 (at an average annual growth rate 3.6 percent), and employment in the industrial sector doubled, from 103,000 to 212,000. Simultaneously, however, overall employment in the Republic declined through the loss of 238,000 agricultural jobs, 670,000 persons emigrated, and the country experienced chronic balance of payments deficits.

The mixed results of the government's protectionist policy, culminated by a period of stagnation in both the manufacturing and agricultural sectors from 1956 to 1958, led to a reappraisal of the government's basic economic strategy. A government report issued in 1958, the Whitaker Report, stressed the need for broad economic planning -- new efforts to attract foreign capital. The Whitaker Report formed the basis for Ireland's two "programs for economic expansion," the first covering the period of 1958 to 1963, and the second covering 1964 to 1970. These programs included policies to remove trade restrictions and encourage foreign investment through a variety of tax incentives, subsidies, grants, and the establishment of free trade zones.

In the period 1960 to 1977, during which Ireland removed many of its trade barriers and offered substantial incentives to investors, over 200 manufacturing projects sponsored by U.S. firms began production in Ireland, with investments in fixed assets amounting to $500 million (45 percent of the total from overseas). Ireland's industrial sector expanded at an average annual rate of 6.1 percent over the 1960s, and GDP expanded at a 4.2 percent average annual rate over the decade. As a result, the rate of emigration slowed, and Ireland's population began to expand.

Ireland is dependent on imported oil for 75 percent of its energy needs, but ironically did not experience an economic downturn -- as did most oil importing countries -- after the oil price increase of 1973-1974. In fact, 1973 marked the beginning of accelerated growth for the Irish economy. Ireland's post-1973 growth can be attributed to its joining the European Economic Community in that year. During a five-year transition period in which Ireland received both preferential trading arrangements and some $2.2 billion in assistance from the European Economic Community (EEC), a surge in manufactured exports as well as a major increase in farm prices more than offset the effects of the 1973-1974 OPEC oil price rise. The rate of real growth from 1974 to 1978 was among the highest in Europe and climbed to six percent in 1977-1978. Moreover, consumer price increases slowed from over 20 percent in 1975 to just over 7 percent in 1978, and by the end of the period unemployment had declined to its lowest point in recent years.

During and following the second round of oil price increases in 1979-1980, however, circumstances were less favorable for Ireland's economy, and a prolonged economic downturn set in. Trade protections granted Ireland as a new E.E.C. member had lapsed in 1978, and wage increases, which had averaged as much as 19 percent annually between 1974 and 1979, diminished the competitiveness of Irish exports. In 1979 Ireland joined the newly-formed European Monetary System which led to the termination of the 153-parity between the Irish pound (the punt) and the United Kingdom's pound sterling. Because Britain remained Ireland's principal trading partner, accounting for 50 percent of imports in 1979, the resultant rise in the price of British imports contributed to domestic wage demands and higher production costs in general, which in turn pushed the inflation rate to 13 percent in 1979 and to 18 percent a year later. By the end of 1980, the punt's value had declined 14 percent against the British pound, with Dublin under pressure to devalue the currency. In 1979 growth in GNP slowed to three percent and in 1980 fell to less than one percent.

The marked slowdown in demand and output growth since late 1979 has been fully reflected in labor market developments. Unemployment has risen sharply, and the continuous upward trend since 1979 brought the rate to about ten percent in April of 1982. The unemployment data exclude first-time job-seekers which, if included, would raise the unemployment rate to over 12 percent. Youth unemployment rates are substantially higher and have shown a more pronounced increase: some estimates indicate that in April 1982 the unemployment rate of the labor force under the age of 25, including first-time job-seekers, was on the order of 18 percent, compared with 9 percent three years earlier. The youth unemployment figure is of particular interest in Ireland, because fully half the population is under 25 years of age and 40 percent is under 19 years of age.

Since 1980 the inflation rate has remained high. Consumer prices rose by 20 percent in 1981 and 17 percent in 1982. This rate is significantly higher than those prevailing in other OECD countries.

The Irish government's budget deficits have increased steadily since the mid-1970s. In 1976 the deficit was U.S. $900 million, in 1979 U.S. $2.2 billion, and in 1982 U.S. $2.9 billion. Efforts to reduce the deficit by cutting expenditures have failed due to successive governments' unwillingness or inability to effect unpopular budget-cutting measures. For example, the Fine Fael-Labour coalition government that emerged after the June 1981 election had planned to reduce the current borrowing requirement from eight percent of GNP to zero over a four-year period. However, when its first major budget was presented in January 1982, the Fine Gael government fell because it failed to secure the vote of one crucial left-wing independent (mainly because food subsidies were abolished and an 18 percent VAT was put on clothing and footwear). Instead of reducing government expenditures, taxes have been raised, and foreign borrowing has increased.

<u>Ireland's International Economic Performance</u>

International trade and investment play an exceptionally important role in Ireland's economy. Exports represented 48 percent of Ireland's total GDP in 1980, and imports accounted for 63 percent of GDP. These figures are, respectively, the second-largest and largest such proportions among the 25 members of the OECD. The expansion of world trade in the 1950s, 1960s, and early 1970s contributed to the rapid expansion of the Irish economy in those years, but the general post-1979 slowdown in world trade and economic growth -- particularly in the British economy, which represents one half of Ireland's export market -- has had a depressing effect on Ireland's exports, and, consequently, on the Irish economy in general. Despite the government's efforts to limit public and private sector wage increases, wage hikes have been high compared to developments in other industrialized countries, thereby eroding the competitiveness of Irish exports and increasing the degree of import penetration.

Ireland runs a chronic and substantial trade deficit, amounting to U.S. $1.6 billion in 1982. Imports consist primarily of capital goods, oil, and raw materials, and many kinds of consumer durables such as cars and household appliances. Ireland's exports consist of food and live animals (35 percent of total exports), machinery and transportation equipment (16 percent), basic manufactures (13 percent) and chemicals (13 percent). Principal trading partners are the United Kingdom, West Germany, France, the United States, and other EC members.

Ireland's current-account deficit, previously more than offset by inflows of foreign capital, is becoming a serious problem. The government's foreign debt servicing and repayments -- which represent 24 percent of government current expenditure (1982) -- add about 400 million Irish pounds to the deficit. Expenditure by Irish tourists abroad has grown relatively rapidly, so that the former sizeable surpluses on tourism had, by 1981, given way to near-balance.

Ireland has the highest per capita debt in the OECD, and foreign reserves in mid-May 1982 covered just over two and a half months' imports, compared with five months' in 1981. The foreign debt outstanding in 1981 was 3.8 billion Irish pounds, compared with 1.1 billion Irish pounds in 1978. Official foreign borrowing was 1.3 billion Irish pounds in 1981, compared with 509 million Irish pounds just two years earlier.

Offshore oil and gas explorations since the 1960s have resulted in only one modest commercial find to date. In July 1983, however, Gulf Oil Corporation announced that it has "encountered hydrocarbon show" off the southern coast of Ireland and will start tests to find out whether these discoveries represent "recoverable quantities." Although there still is no proof that this will be a commercial field, even modest production of 80,000 barrels per day (Ireland's current rate of oil imports) could have a significant impact on Ireland's external position. Ireland's current energy bill of U.S. $1.2 billion per year is equal to its payments deficit, so any oil find probably would eliminate the deficit, and government oil revenue would greatly facilitate servicing of Ireland's external debt.

Since joining the European Monetary System in March 1979, the Irish pound has depreciated 20 percent against the pound sterling, 35 percent against the U.S. dollar, 10 percent against the Deutschmark, and 8 percent against the Dutch guilder. It has appreciated 8 percent against the French franc and the Belgian franc and 13.5 percent against the Italian lira.

Investment Climate

The generous investment incentives that Ireland has offered to investors since the late 1950s, combined with Ireland's attractive supply-related characteristics and EC membership, have led to approximately 2.5 billion Irish pounds of direct foreign investment in new industrial ventures in Ireland since 1960. Approximately 70 percent of this investment has been accounted for by U.S. companies. U.S. companies in particular are attracted by Ireland's tariff-free access and close proximity to the European Community, and by the lack of a language barrier in Ireland. The remaining investment has been accounted for by European countries (24 percent) and non-European investors (mainly Japan, 4 percent).

U.S. Department of Commerce statistics show that Ireland is the most profitable country in the world for U.S. operations. In the 1974-77 period, U.S. subsidiaries in Ireland earned an average annual return on capital of 28.5 percent. This figure compared with an average return on investment of 12.8 percent for U.S. subsidiaries throughout the EC and a worldwide figure of 12.3 percent.

The investment incentives that Ireland offers are among the most comprehensive available to an investor. The Industrial Development Authority (IDA), a parastatal agency formed in 1951, provides nonrepayable cash grants toward the cost of fixed assets for new industrial undertakings and for service companies in proportion to the jobs they create. Grants for fixed assets may be negotiated up to 60 percent of cost in the comparatively underindustrialized western areas of the country and up to 45 percent in most other areas. Capital-intensive projects may receive IDA guarantees on interest and principal of foreign borrowings; the IDA can also subsidize interest rates. Grants are provided to cover the wages of workers during their training period in Ireland and for the travel, wage, and living expenses of workers trained abroad. Grants are available for infrastructure investment and for the rental of factory space of up to ten years, depending on the location of the factory. Research and development projects and consulting costs may also qualify for cash grants.

Changes may soon take place in the government's investment incentives policy. A recent study conducted for the National Economic and Social Council criticized the leniency of tax-based financing and pointed out that the current tax regime does not adequately attract marketing, engineering and R&D services. The study suggests that capital grants be cut in half and that more grants be made available for indigenous investments. While the study has yet to be accepted and its recommendations implemented, some observers feel that the results could foreshadow the end of Ireland's generous incentives system.

Labor problems are persistent. Ireland leads the Common Market in industrial disputes. Although work days lost to strikes have declined from their postware record in 1979, labor disputes, primarily from the public sector unions, continue to disrupt both personal and business life. Absenteeism, another characteristic of the Irish industrial labor climate, is belived to be as high as 15 percent in some sectors.

Conclusions

The Irish economy remains one of the least developed of the northern European economies. Agriculture in Ireland employs a higher percentage of the labor force (19 percent) and represents a larger share of GDP than in most other industrial market economies. Industry has expanded from a relatively small base in the 1960s, to the point in 1978 when industry represented 33 percent of GDP. International trade and investment is extremely important to the Irish economy: exports represent one half of GDP, and imports nearly two thirds. The Irish economy mirrored the expansion of world trade and investment in the 1950s, 1960s, and early 1970s, and Ireland benefitted from joining the European Community in 1973.

Since the mid-1970s, the slowdown in world trade, the rise in the price of petroleum and in world interest rates, and inappropriate domestic fiscal policies have contributed to a slowdown in the Irish GDP growth rate and an increase in the unemployment and inflation rates. Despite these recent unfavorable developments, Ireland's generous investment incentives packages, its skilled and relatively low-cost labor force and its proximity and tariff-free access to the European Community market should enable Ireland to continue to attract foreign investment.

TAIWAN'S BUSINESS AND INVESTMENT CLIMATE

Introduction

Taiwan's real GNP growth rate in the 1960s and 1970s averaged 10 percent per annum--among the highest GNP growth rates in the world. Trade has led Taiwan's economic growth, with exports representing 55 percent of GNP in 1982 and perhaps as much as 65 percent by 1989. The composition of exports has evolved from agricultural and labor-intensive manufactured goods in the 1960s and early 1970s toward more technology and capital-intensive manufactured and capital goods. Taiwan's small but strong agricultural base, political stability, well-educated and productive labor force, and significant investment inflows have also contributed to Taiwan's economic growth. The government has played an active role in the expansion and evolution of Taiwan's economy.

Background

From 1895 to 1945, Taiwan was a colony of Imperial Japan. The Japanese rulers concentrated on developing Taiwan as a source of agricultural commodities, and irrigation works and transportation routes were constructed to speed the export to Japan of sugar, rice, bananas, pineapples, and other agricultural products. Some processing plants and mining operations were added to Taiwan's economic base in the 1930s, and hence Taiwan's economy was more highly developed than that of mainland China at the time of the outbreak of World War II.

During the war and until 1949, several shocks radically strained and transformed Taiwan's economy. Taiwan was bombed heavily during the war, and much of its infrastructure was destroyed. The post-war evacuation of the Japanese left Taiwan with major gaps in management and organizational expertise. Finally, the communist victory in mainland China caused a massive inflow of population and established Taiwan as the seat of government in a more-or-less permanent state of war.

The loss of the Japanese and Chinese export markets, the sudden absorption of two million mainlanders, and high military tensions led to economic stagnation, runaway inflation and severe foreign exchange shortages by the late 1940s. In response, the Taiwanese government, led by the Nationalist leader Chiang Kai-Shek, instituted an import substitution policy of strict foreign exchange and import controls. The government also imposed price controls and instituted a successful land reform program.

By the mid-1950s, the growth of manufacturing slowed due to the saturation of the domestic market for "easy" manufactures and persistent balance of payments deficits. After a few years of makeshift policy adjustments, the Chinese authorities finally took decisive steps in the late 1950s to reorient the overall thrust of policy incentives in favor of export activity. The government also made heavy investments in roads, railroads, air and sea travel facilities, and electrical power plants, some of which were funded by U.S. economic assistance prior to the end of the aid program.

During the 1960s, exports of goods other than the two major traditional export products, rice and sugar, increased by an annual compound rate of 32 percent. During the same period, manufacturing production increased by 17 percent per year, agricultural production by 5 percent per year, and GNP in real terms by over 10 percent per year. Gross domestic savings rose from 10 percent of GNP in the late 1950s to 24 percent in the late 1960s. Prices stabilized and the exchange rate of the Taiwan dollar did not change in the 1960s. Sustained inflows of investment capital and loans reversed the rampant flight of private capital of the late 1940s and early 1950s. Taiwan also received $1.5 billion in U.S. economic aid and $3.6 billion in U.S. military aid between the outbreak of the Korean War and the termination of aid payments in 1965.

Taiwan's average annual GNP growth rate slowed moderately from 10.8 percent (1963 to 1972) to 8.7 percent (1973 to 1980), due to the slowdown in world trade, the increase in price of Taiwan's petroleum imports, and increased trade competition from other developing countries. In 1980 Taiwan's GNP grew by 5.5 percent and in 1982 by 3.8 percent--about the same as most of its Asian neighbors' growth rates and well above the slow or negative growth rates experienced in the industrialized economies.

The government is currently working to encourage the evolution of Taiwan's production away from labor-intensive manufactured goods and towards technology and capital-intensive manufactured and capital goods. Should Taiwan succeed in effecting this transformation (given stiff competition from several like-minded newly industrializing countries), and should world trade increase and energy prices remain stable, then Taiwan could reach its goal of 8 percent annual real growth in GNP as outlined in Taiwan's 1982-85 Economic Development Plan.

Taiwan has also been particularly successful in national social performance. Taiwan's health, education, and welfare indicators are all well above the developing-country average and in some cases approach or exceed the level of the industrialized countries. Life expectancy in Taiwan is 72 years (developed countries' average life expectancy is 73 years), and Taiwan's infant mortality rate is 9.1 deaths per 1000 live births. The overall literacy rate is 82 percent (the developing countries' average is 55 percent). Nine years of schooling are compulsory, and the government provides vocational and occupational training and supports scientific and advanced technical studies in public and private colleges and universities. Income is also evenly distributed in Taiwan in comparison with the performance of either developed or developing countries.

The Chinese who escaped from the mainland in 1949, along with their descedants, constitute only 15 percent of the population of Taiwan. However, the Kuomintang Nationalist party controls the government of Taiwan and claims to represent all of China. Chiang Kai-shek led the government from 1949 until his death in 1975, and his son is currently president. The native Taiwanese own most of Taiwan's industry and land, and are trying to increase their power in the national government. Internal political competition has been muted, and national unity has been enhanced by the perceived common threat from the mainland, which considers Taiwan a rightful province of mainland China.

Taiwan's Domestic Economic Performance

GNP in 1981 amounted to U.S. $56.1 million*, which, with Taiwan's population of 19 million, resulted in a per capita GNP of approximately $2,400. This represents a marked increase from 1952, when per capita GNP was only $148. Among Asian countries, only Japan ($10,330), Hong Kong (5,460), and Singapore ($5,220) have higher per capita GNP levels.

Taiwan's long term growth rate borders on the extraordinary, averaging 9 percent since 1952. In fact, President Chiang Ching-Kuo refers to the current slow growth performance as a "recession." Agriculture, industry, manufacturing, and investment and finance all experienced slow growth rates in 1981, and foreign trade in 1982 declined, for the first time in seven years, by 6.2 percent. In order to stimulate economic growth, the authorities have taken a number of steps, including a 5 percent depreciation of the NT dollar, a four-point stimulus program, and a nine-point economic recovery package. Customs duties on selected machinery were lowered; interest rates were reduced; loans were made easier for borrowers; and tax incentives were given to more industries. However, because of weak demand and because of the existence of about 25 percent excess capacity, these policy stimuli did not have the desired effect until 1983, when export-led recovery commenced. Exports in June 1983 were up 18 percent to $2.2 billion, the highest figure in 22 months, and GNP growth is projected at 6 percent in 1983.

The inflation rate slowed substantially in 1982. Consumer prices rose by 4.1 percent, compared with increases of 19.0 percent in 1980 and 16.3 percent in 1981. In 1983, sluggish growth, lower wage hikes, and falling oil prices held inflation to between 4 and 6 percent.

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* All figures cited are in U.S. dollars

Taiwan's unemployment rate rose from 1.23 percent in 1980 to 1.43 percent in 1982. While these rates are extremely low, and are in part due to different standards of measure, the economic slowdown in 1981 and the trend toward automation have caused some underemployment. Real wages and labor productivity have increased significantly and in concert in recent years. From 1975 to 1981, real wages rose by 8.5 percent per year, while labor productivity increased by a rate of 10.2 percent per year.

For the last twenty years, Taiwan has depended on low-wage, primarily low-skilled labor in its export-driven economy. Rapid increases in the education level, however, have caused unemployment and underemployment among skilled workers. In 1981, for example, the ratio of job-seekers to job vacancies among primary school graduates was only .23, while for college graduates and above, the ratio was 6.88. Economic planners have recognized the current industrial structure's inability to absorb skilled workers, and developing technology-intensive industries is seen as a means not only of absorbing skilled labor but also of increasing Taiwan's export competitiveness.

Taiwan's International Economic Performance

Taiwan's economy remains fundamentally trade-based. Two-way trade amounted to $41.1 billion in 1982. Exports and imports each represent about one half of GNP. Taiwan has recorded a trade surplus in every year since 1976. In 1982, Taiwan's trade surplus amounted to $3.3 billion.

Although Taiwan maintains full diplomatic relations with only some twenty small countries, Taiwan maintains commercial relationships with over 150 nations. The United States and Japan are by far Taiwan's largest trading partners. In seeking to diversify both its trade sources and its customers, Taiwan has increased its commercial links with Western Europe, the Middle East, and Africa.

The composition of Taiwan's external trade has changed fundamentally in the last three decades. Agricultural exports as a percent of total exports declined from 95 percent in 1952 to only 8 percent in 1981, while industrial products grew from only 5 percent to 92 percent during the same period. Consumer goods as a percent of total imports dropped from 13 percent in 1952 to 6 percent in 1981, while capital goods rose from 13 percent to 25 percent. Textile products are currently the leading export item, taking a share of 21 percent of the export total, followed by electrical machinery and appliances, with an 18 percent share. Major import items are crude oil, constituting 21 percent of the total, and machinery. As part of its long-run plans to shift the composition of its exports, Taiwan has begun to sell whole manufacturing plants, especially to Southeast Asian firms operated by overseas Chinese.

Taiwan's credit standing is excellent in international capital markets, despite its loss of membership in the International Monetary Fund and the World Bank. Taiwan's debt-service ratio (interest and principal payments to exports) is among the lowest in the world (6.4 percent in 1980 and 7.7 percent in 1981). Taiwan's total external public debt was $5.1 billion at the end of 1980 and $6.1 billion at the end of 1981. The New Taiwan Dollar (NT$) stabilized in the 1960s at 40 to the U.S. dollar and appreciated to NT$38:US$1 in 1973 and NT$36:US$1 in 1978. It has been subject since 1979 to a controlled float and is expected to stay within a range of NT$39.50:US$1 to NT$42:US$1 during most of 1983.

Investment Climate

The government has actively encouraged foreign and domestic investment in Taiwan through a combination of tax benefits, accelerated depreciation, export processing zones, unlimited repatriation of profits and interest, and other incentives for approved manufacturing industries. In 1980 the law to encourage investment (initially enacted in 1962) was extended for ten years, and extra advantages were offered to firms engaged in priority industries. Priority industries include heavy industry, high technology industries, power generation and energy conservation, precision machinery, automation and defense-oriented materials. Projects exhibiting strong export potential or producing intermediate goods for such industries as petrochemicals and steel will also be promoted. To attract such industries and provide employment for skilled Taiwanese, the government has recently constructed an industrial science park intended for firms specializing in such products as minicomputers, microfilms, and integrated circuits.

Taiwan has had an average annual inflow of $500 million in long-term capital in recent years. In 1981, the inflow of $839 million was mainly used in the construction of infrastructure, including power plants, railways, and port facilities. Of the total inflow, net foreign investment was $101 million and net foreign long-term loans amounted to $738 million. Total foreign investment approvals in 1981 were $396 million, of which U.S. firms accounted for $203 million.

Overall, investors see Taiwan as offering a broad range of advantages, including a moderately generous incentive package, a disciplined and well-educated labor force (although unskilled labor remains in short supply), a prohibition against strikes, and an absence of independent labor organizations. One of the hindrances to investment has been the absence of patent and copyright protection, but the prospects for protective legislation in this area are improving. Firms are also subject in many cases to minimum export requirements and local content requirements. These provisions are of growing concern among the business community.

Summary

Taiwan's priority in the 1940s and early 1950s was to maintain political, military, and economic order in the face of many strong shocks experienced domestically and internationally. The Nationalist government maintained order and followed an import substitution-based policy in the 1950s. After the import substitution policy had run its course, Taiwan adopted an export-led strategy beginning in the late 1950s and continuing through the present. Taiwan's success in export-led growth, as well as its high rates of domestic savings and foreign investment inflows, have enabled Taiwan to attain a per capita GNP and a level of industrialization typical of the "newly industrialized countries." Depressed world economic conditions in recent years have slowed Taiwan's economic growth rates. Recovery in Taiwan's export markets and transformation of Taiwan's economy to more technology and capital-intensive production is expected to lead to increased rates of growth in the medium and long run. Overall, and particularly in comparison with other developing countries, Taiwan remains a highly attractive investment climate for firms whose activities coincide with Taiwan's development objectives.

JAMAICA'S BUSINESS AND INVESTMENT CLIMATE

Introduction

In the 1950s and 1960s, Jamaican economic development efforts centered around developing Jamaica's large bauxite reserves discovered in the 1950s, expanding the tourist industry, and encouraging domestic industry through an import-substitution based industrialization policy. Successful efforts in these areas, combined with a rich agricultural base, enabled Jamaica to obtain annual GNP growth rates averaging 4.4 percent in the 1960s.

The oil price rise of 1973, however, was the first in a series of unfavorable internal and external developments which led Jamaica to experience negative growth rates in every year from 1973 to 1980. Deterioration of the investment climate, unfavorable publicity for the tourist industry, and inappropriate fiscal and monetary policies caused GNP to decline between 1973 and 1980 by 18.3 percent overall and by as much as 25 percent per capita. By 1980, unemployment had grown to over 30 percent of the labor force, and inflation reached nearly 30 percent per year. In 1980, the government which had presided over the decline, the People's National Party led by Michael Manley, was voted out of office in favor of the Jamaica Labour Party.

The new Prime Minister, Edward Seaga, has actively sought to increase domestic and foreign investment in order to revitalize the Jamaican economy. Jamaica's investment laws have been reformed, and investment promotion offices have been established locally and overseas. Prime Minister Seaga has also strengthened Jamaica's political and economic ties with the United States, Jamaica's main trading partner. Prime Minister Seaga's efforts resulted in initial successes. For example, GNP grew by 2.0 percent in 1981 and by an estimated 3 percent in 1982, which represent significant achievements given the depressed condition of the world economy over the period. Over the course of 1983, however, this forward momentum was halted due to a number of factors, primarily shortages of foreign exchange.

Under the Jamaica Labour Party, Jamaica's prospects for long term growth appear to be good. Jamaica has received the "confidence" of the world financial community as indicated by large loans being secured from the International Monetary Fund, the World Bank, the Inter-American Development Bank, bilateral donors, and commercial banks. Whereas private investment was negligible in 1980, 22 new projects worth U.S. $21.0 million were realized in 1981 and an additional 94 projects were implemented in 1982. Demand for Jamaica's principal export commodity--bauxite and its processed derivative alumina--is expected to expand as the world economic recovery proceeds.

Jamaica's Domestic Economic Performance

Jamaica's GDP in 1980 amounted to 2.7 billion U.S. dollars, which reflected a negative average annual growth rate of 1.1 percent over the previous decade. This compares unfavorably to an average annual growth rate of 4.4 percent from 1960 to 1970.

Several domestic factors help explain Jamaica's poor economic performance in the 1970s. The Manley administration was elected in 1972 on a platform of "democratic socialism" aimed at diversifying the economy, reducing urban unemployment, and redistributing income. The People's National Party (PNP) increased government spending without corresponding increases in revenue, which eventually contributed to a 25 percent average annual inflation rate over the 1976 to 1980 period. The PNP government increased foreign borrowing and drew down its foreign exchange reserves to the point where, by the mid-1970s, shortages of foreign exchange caused cutbacks and closings of dozens of factories for lack of imported raw materials, equipment, and spare parts.

The PNP government's policy toward the bauxite mining companies also contributed to the economic decline. In 1974 the government acquired a 51 percent interest in the major bauxite mining operations and attempted to expropriate all landholdings previously sold to the multinational companies. Although some such agreements were concluded, two mining companies withdrew from Jamaica and others scaled down their operations.

This contributed to a 32 percent decline in output of bauxite in 1975 and a 42 percent drop in alumina production between 1974 and 1976.

The government attempted to increase agricultural production through a land redistribution program and the establishment of eighteen large, state-supervised agricultural farms. These efforts were not successful. Agricultural output showed an average yearly gain of only 0.7 percent from 1970 to 1980, compared with 1.5 percent average annual growth from 1960 to 1970. Floods in 1979 and Hurricane Allen in 1980 caused substantial damage to agricultural productive capacity.

Because all sectors of the economy were stagnant or declining from 1973 to 1980, and the labor force was growing at an average annual rate of 2.4 percent, unemployment reached over 30 percent of the labor force by 1980. Despite such high unemployment levels, Jamaica's trade unions, the Bustamante Industrial Trade Union (BITU) and the National Workers Union (NWU), each organized in the late 1930s, joined with public sector employees to put pressure on the government for higher wages. Such wage demands contributed to the government's inability to meet fiscal adjustment targets set by the International Monetary Fund in 1977 and 1979, so credit arrangements were canceled or suspended in those years. Subsequent negotiations with the International Monetary Fund were broken off by the Manley government in 1980.

In February 1980, with unemployment nearly 30 percent, the annual inflation rate at 30 percent, and GNP declining at 5 percent annually, the Manley administration called for early elections. In the most violent election campaign in Jamaican history, the Jamaica Labour Party (JLP) criticized the People's National Party (PNP) for its poor economic performance, non-productive relations with the International Monetary Fund, and its close relations with Cuba. With support from the business community, agricultural interests, and the 100,000 member Bustamante Industrial Trade Union, the JLP was elected by an overwhelming majority in October 1980.

Immediately upon taking office, the Seaga government undertook a structural reform program that included revision of the tax system, deregulation of private enterprise, privatization of companies acquired by the Manley government, encouragement of export-oriented ventures, a decrease in protectionist measures and import licenses, relaxation of price controls, and a three-year freeze on public hiring. The Seaga government also agreed to limit the growth of public credit, central bank assets and foreign borrowing as terms of a three-year U.S. $700 million credit secured from the International Monetary Fund in 1981.

The effect of these reforms on Jamaica's economic performance were initially positive. GNP grew by 2.0 percent in 1981, including a 3.0 percent annual growth in the agricultural sector. Monitored new private investment, which was negligible in 1980, grew to U.S. $21.0 million in 1981. Expansion of the economy caused unemployment to fall slightly in 1981, and a tight monetary policy caused inflation to slow from annual rates in the range of 25-30 percent in the late 1970s to less than 5 percent in 1981.

Jamaica's International Economic Performance

Jamaica's primary export commodity is bauxite and its processed derivative alumina, which jointly accounted for 68 percent of export earnings in 1982. In 1974, Jamaica, Australia, and eight other countries formed the International Bauxite Association in an attempt to emulate the success of the OPEC cartel. Jamaica pegged its tax on bauxite to the aluminum ingot price in the United States, which resulted in an immediate six-fold increase in Jamaica's bauxite tax revenues. In the mid and late 1970s, however, there was a recession-induced slowdown in demand for bauxite, aggravated by increased production costs due to the highly energy-intensive nature of bauxite production. By the late 1970s, Jamaica's annual production of bauxite had dropped by nearly 3.5 million tons, and in 1979 Jamaica's bauxite levy was reduced to reflect slack demand conditions.

The remainder of Jamaica's exports are accounted for by sugar (7 percent of Jamaica's total export earnings in 1982), other agricultural exports (bananas, coffee, citrus, spices, and tobacco), and miscellaneous manufactured exports (processed foods, rum, liqueurs and cordials, cigars, garments, and furniture).

Jamaica's imports have been constrained since 1973 by the high cost of imported oil. Jamaica is dependent on imported oil for 90 percent of its domestic energy needs. Energy imports as a percentage of merchandise exports rose from 11 percent in 1960 to 39 percent in 1979. Non-petroleum imports include food (17 percent of total imports), machinery and transportation equipment (14 percent of total imports), electrical equipment, and fertilizer.

As a result of long-standing, chronic foreign exchange shortages, an import licensing system covering nearly 300 categories of goods was established in 1965, but in 1981 the government pledged to eliminate most of these restrictions over a five-year period under the terms of a U.S. $75 million "Structural Adjustment" loan from the World Bank.

Jamaica's deficit on current account was financed in the 1970s by foreign borrowing. By 1980 Jamaica's foreign debt (guaranteed and direct) reached $1.6 billion, and service payments thereon were equal to half of Jamaica's total anticipated export earnings over the following three years. The recent growth in the economy has aggravated Jamaica's current account deficit by increasing domestic demand for primary good and consumer good imports. Jamaica's deficit worsened from U.S. $148 million in 1980 to U.S. $427 million in 1981.

To help finance imports and service the foreign debt, Prime Minister Seaga secured U.S. $700 million balance of payments assistance in 1981 from the International Monetary Fund and an even larger amount from other donors (World Bank, Inter-American Development Bank, bilateral donors, and commercial banks).

Jamaica's primary export markets are, as shown in percentages of total exports in 1981, the United States (37 percent), United Kingdom (19 percent), Canada (4.7 percent), Norway (11 percent), and CARICOM (7 percent). Principal sources of imports are United States (37 percent), Venezuela (12 percent), United Kingdom (6.6 percent), Canada (5.4 percent), Netherlands Antilles (16.5 percent), and CARICOM (8 percent).

The Jamaican dollar, which is tied to the U.S. dollar, has declined in value by over two-thirds since 1977, from a Jamaican dollar value of U.S. $1.11 to a current value of about U.S. $.32. The formal devaluation effected, in December, 1983, was undertaken to correct the previous over-valuation of the Jamaican dollar.

Investment Climate

The government has recently taken many steps to increase foreign and domestic investment in Jamaica. It has removed many restrictions on foreign investment that had been established by the PNP government. It has re-established active use of long-standing tax holidays, tax credits, and customs duty exemptions for investors, and has revitalized a Free Zone in Kingston. The convertibility and free remission of profits is guaranteed. The government established the Jamaica National Investment Promotion Ltd (JNIP) in 1981 to assist and advise potential investors.

Initital indications suggest that Jamaica's call for increased private investment is meeting with some success. According to the JNIP, during its first year of operations, 470 investment proposals worth a total of $750 million were received, including some 300 proposals from foreign sources. Of these proposals, 22 actually sent into production in 1981 and the pace of project implementation has accelerated since then.

In addition to the government's legislative and promotional efforts, other more basic factors contribute to Jamaica's gradually more favorable investment climate. Jamaica's financial, communications, and transportation infrastructure is relatively well developed. Jamaica's English-speaking labor force is relatively healthy (with life expectancy at

71 years and infant mortality rate of 28 per 1000 births) and well-educated (adult literacy rate is about 90 percent). Jamaica's even, sub-tropical climate is well-suited to tourism and to cultivation of a variety of high value crops. Jamaican exports also enjoy preferential access to markets in the United States (through the GSP and CBI), in Europe (through the Lome Convention), and in the CARICOM countries.

EGYPT'S BUSINESS AND INVESTMENT CLIMATE

Introduction

Egypt's importance in the Middle East region stems from many factors: its strategic location as a frontline state with Israel and as a crossroads between Europe and the African continent; its considerable population (46 million), making it the largest of the Arab countries and second largest nation in Africa; its armed forces, numbering 850,000 (regular and reserves) which represent the strongest Arab military force; and its historic role as cultural and political leader in the Arab World, as demonstrated during the Nasser regime (1952-1970).

Through a period of prolonged tension in her external relations with neighboring countries, Egypt's domestic problems have mounted. The growth of population remains high at 3.1 percent per annum. Per capita income is U.S. $654 (1983). Significant discrepancies in income exist between those in the countryside (50 percent of the population is engaged in agriculture) and those in the urban middle and upper classes. Although basic education and medical facilities have been extended throughout the country since independence (1952), the rate of illiteracy is 56 percent, and infant mortality at 102 per 1000 births is considered unacceptable by international standards. Furthermore, Egypt's economic infrastructure is in need of major maintenance and repair to avoid serious deterioration.

In part to address these problems, President Sadat undertook to establish peace with Israel in order to help restore some semblance of domestic economic development. With the signing of the Camp David accords in 1979 and the return of the last of Sinai in April 1982, the peace was attained, and with it came many benefits. The U.S. government has provided Egypt with U.S. $1 billion/year in economic aid as part of the peace package, and European Governments and Japan have contributed an additional $1 billion. Egypt regained possession of the Sinai oil fields, production from which provides for Egypt's domestic needs and earns $2.8 billion annually (1981). The Suez Canal, closed in the 1967 war, reopened in 1975 and currently earns U.S. $90 million per year. The Egyptian military, which still commands 20 percent of the national budget (1979-80), has been freed to perform many civilian tasks such as telephone line installation and non-military industrial production.

The benefits of peace as well as other favorable factors such as rapidly rising workers' remittances have contributed to Egypt's strong economic performance in the last decade. Per capita income grew by 5.5 percent over the period of 1970-79. But questions such as how long Egypt's economic growth can be sustained, whether its growth will keep pace with the population's expectations, and whether Egypt will be able to solve many deep-rooted problems that beset its economy, remain unanswered.

Egypt's Domestic Economic Performance

Egypt's GNP in 1980 amounted to $23 billion. This figure reflected an average annual growth rate of 6.4 percent over the previous decade. Sectoral share and growth rates are shown below.

Agriculture is confined to the Nile Valley and Delta regions, which constitute only three percent of Egypt's total land area. Due to its ideal weather conditions and the richness of its topsoil, the Nile Valley and Delta are among the world's most fertile agricultural lands. Perennial irrigation following construction of the Aswan dam in 1960 has expanded Egypt's agricultural capacity. Since independence, however, the government's concentration on industrialization, when combined with pressure for land from "urban sprawl" and a government pricing system which fails to reward farmers adequately for their efforts, has caused agriculture to record the lowest growth rate of all sectors (2.7 percent annually over the 1970s). Slow agricultural expansion along with rapid population growth has transformed Egypt from a net food exporter through 1974 to a net importer. Currently, half of Egypt's food needs are supplied by imports, at a cost of U.S. $3 billion annually.

Industry consists largely of oil production and various manufacturing enterprises aimed at supplying local consumers. In the 1960s, President Nasser nationalized all domestic and foreign firms with fifty or more employees, so that today some 70 percent of industrial output is accounted for by public sector firms. Under President Sadat and his successor, President Mubarak, efforts have been made to dismantle some of the public sector organizations and to increase the role of the private sector, but the general population and the government still view the motives of the private sector with some suspicion, and the interests and power of the public sector firms are well-entrenched. As a result, progress towards privatization of the Egyptian economy has been slow.

Services contribute the largest share, 42 percent, to Egypt's GDP. Chief among them are international transactions such as tourism, Suez canal revenues and remittances from the estimated 1.5-3.5 million Egyptians working abroad.

Tourism: The worldwide recession and the October 1981 assassination of President Sadat have depressed tourist revenues, which fell by 14 percent in 1981-82, from U.S. $700 million to U.S. $600 million. Several expansions of Egypt's tourist facilities are being undertaken, not only in Cairo and the upper Egyptian towns of Luxor and Aswan, but also in non-traditional areas such as the Red Sea coast and the Sinai peninsula.

Suez Canal: World tanker traffic has been down, but tolls were raised six percent on January 1, 1983, and the canal was recently widened and deepened to allow the passage of larger draft ships. Revenues for 1982 were U.S. $888 million, down slightly from 1981.

Remittances: Spending in the Arab oil-rich states has slowed, and with it the prospects for continued absorption of Egypt's skilled, semi-skilled, and unskilled labor have diminished. Remittances dropped from U.S. $2.6 billion to U.S. $1.7 billion from 1980-81 to 1981-82, which some see as signalling a sunset for this important source of foreign exchange. Egyptian officials remain optimistic, however, that worker remittances will remain at high levels.

Inflation averaged 11.5 percent annually in the 1970s and is currently running at an estimated annual rate of 25 percent. Extensive subsidies and price controls on most food, fuel, housing, and clothing items have worked to shield most Egyptians from the full effect of inflationary pressures. But these subsidies incur large budgetary costs--U.S. $2.4 billion in 1981--and result both in structural economic distortions and the widespread misallocation of resources. Economists from the International Monetary Fund, the World Bank, and the Agency for International Development have all urged Egypt to reduce subsidies, but the bloody riots which followed the short-lived lifting of price controls in January 1977 clearly demonstrate the political dangers of such reform. Egypt's budget deficit (total expenditures less total revenues) in 1982-83 is estimated at U.S. $5.7 billion, of which U.S. $1.8 billion is to be covered by deficit financing through the banking system, further adding to inflationary pressure.

Unemployment, estimated at 10-15 percent, has been alleviated somewhat by the exodus of Egyptian workers to the oil-rich Arab countries. In fact, shortages of skilled blue-collar, technical, and managerial talent have been experienced. In addition, Egypt's public sector has disguised a good deal of unemployment through a law guaranteeing public sector employment to the 70,000 annual graduates of the free university system.

Egypt's International Economic Performance

Egypt's exports consist mainly of petroleum, agricultural products (particularly cotton), and smaller amounts of various manufactured goods such as textiles and consumer goods. Due to increasing production and increased world prices, earnings from crude and refined petroleum exports rose from U.S. $481 million in 1978 to U.S. $2,064 million in 1981. The latter figure represented 64 percent of Egypt's merchandise exports in 1981. The recent decline in world oil demand has forced the Egyptians to lower their prices. Cotton exports have increased four percent per year from 1976 (U.S. $381 million) to 1981 (U.S. $457 million). Egypt's imports, however, nearly doubled from 1977 (U.S. $4,038 million) to 1981 (U.S. $7,918 million), resulting in an annual merchandise trade deficit of U.S. $3-4 billion since 1978. This has been only partially offset by Egypt's positive serice account balance.

Egypt's foreign debt amounted to U.S. $13 billion in 1982, most of which is concessional foreign assistance from the U.S. government and the World Bank. Service payments thereon represented 20 percent of export earnings, compared to much higher debt service ratios for countries such as Mexico (58 percent) and Argentina (78 percent).

Egypt's currency is tied to the dollar and has been devalued twice since 1978. Access to foreign exchange through official channels is restricted, giving rise to a flourishing but technically illegal "free market" which discounts the official rate roughly 40 percent.

Investment Climate

Legislation: To fill the gap between Egypt's domestic savings and her projected investment needs, the government has actively encouraged foreign investment since 1974. In that year Sadat announced the so-called Open Door Policy, known as Al-Infitah, which is embodied in Public Law 43. Law 43 allows repatriation of profits from joint-venture investments, and provides foreign investors with exemptions from certain taxes, customs duties, profit-sharing requirements, and labor laws. Because certain provisions of Law 43 conflicted with previous laws, an amendement was passed in 1977 asserting the primacy of Law 43 over any conflicting laws and extending the benefits of Law 43 to indigenous investments. As a further step to attract investment, duty free zones have been established in the Suez Canal city of Port Said, in Alexandria, and in the new Nasr City.

Results: The amount and scope of foreign investment since 1974 have been less than hoped for. Under Law 43, the investment authority has approved 1,626 projects inland and in the free zones, with total capital of

U.S. $5.5 billion and a total investment cost of U.S. $11.7 billion. However, the majority of investments have been in petroleum and related fields. For example, in 1980-81, direct foreign investment in Egypt was about $1 billion, three quarters of which was in the petroleum sector. Most of the non-petroleum investment has centered on banking, investment and consulting services, and tourism projects rather than on productive manufacturing. The U.S. Embassy estimates that apart from the banking and services industries, only 12 to 18 U.S. companies are currently doing business under Public Law 43. U.S. direct investment as a share of total non-petroleum direct foreign investment is 17 percent, EEC 19 percent, Arab 33 percent, with the remaining 31 percent originating from other sources.

Recent Developments: The new Investment Minister Wagih Shindy has recently taken additional steps to encourage investment, such as allowing foreign firms to take a majority holding in joint venture companies in Egypt and promising final decisions on investment applications with 120 days, although delays are still encountered. Egyptian government officials have expressed concern that the Open Door Policy must be a productive policy, featuring investment in such fields as agriculture, housing, manufacturing, and industrial enterprises, not in banking, warehousing, and consumer goods marketing.

Obstacles to Investment: Despite the passage of such investment-encouraging laws and the issuance of official statements, the climate remains unpromising to prospective investors. By virtually all accounts, U.S. businessmen and institutions who evaluate country risks rank Egypt's business climate at the low end of the scale of those LDCs which are in competition for foreign investment. Aside from the speculative question of Egypt's long-term (or near-term) political and economic stability, several current factors explain Egypt's lack of attractiveness to investors.

Bureaucracy: All of the negative images that come to mind from this term apply to the Egyptian bureaucracy, such as overstaffed and unproductive offices, unclear and over-lapping lines of authority, contradictory rulings by competing and often redundant agencies, inability to reach timely decisions, wheels that will not move without "lubrication," and so forth. There also exists in Egypt a public sector preference, in which the local public sector firm may enjoy several advantages over a foreign competitor such as government production subsidies, access to foreign capital at low official rates, and preferential treatment in government purchasing decisions. Furthermore, some investment laws are not enforced.

Many companies doing business in Egypt find the customs authorities a law unto themselves, and snarls in the importation of necessary equipment and materials are frequent. Under Law 43 and by special decree, some taxes, custom duties, and other tariffs on the import of machinery and equipment can be waived, but customs officials do not necessarily abide by such decrees.

Infrastructure Problems: Public authorities have recognized that the economic infrastructure of Egypt must be improved. With international assistance, Egypt has made progress toward that end. Roads, tunnels, and bridges have been built, internal and external communications have been improved, and electricity and water service has become more reliable. Nevertheless, breakdowns in these services are not uncommon, and operating a business in Egypt still requires a high degree of perseverence.

Attitude toward Private Enterprise: Increased privatization of the Egyptian economy has been recognized as a way of increasing the efficiency and quality of industrial output and of attracting much-needed foreign investment to Egypt. Public and private attitudes toward private investment, however, remain ambivalent. Some intellectuals and opposition newspapers have complained that the Open Door Policy represents the selling of Egypt to foreigners and the coopting of Egyptian policymakers by the international entities calling for greater privatization of the Egyptian economy. Joint venture investments have been criticized for not entering the "productive" sectors: iron and steel, agriculture, and manufacturing. Joint venture enterprises have also been criticized in the press for competing against public sector firms "unfairly" due to the joint venture firms' exemption from many local taxes, profit-sharing, and labor provisions.

Due to the perception of many Egyptians that the private sector is exploitative, non-productive, and profiteering, the Egyptian Government has been reluctant to relax its control over private sector expansion.

The Egyptian Government has recently begun defining the areas in which private sector participation is desired, but it has yet to develop an overall private sector development strategy. When announcing the shift toward a mixed economy, the government made it clear that it was not seeking to dismantle Egypt's socialist structure, nor did it intend for the private sector to compete directly with some of the more basic nationally owned industries. Rather, the role of private investment was seen as supporting the national system in existence. An expanded private sector also was seen as providing a stimulus for improving existing public sector industries. How this is to be accomplished has not been specified.

The lack of a clearly defined role for the private sector and a favoritism towards the public sector are major impediments to expanding private sector investment in Egypt. The new five-year plan addresses this lack of guidelines by identifying the sectors in which private investment is most actively encouraged (agriculture and agribusiness, construction and housing, tourism, and petroleum).

Summary

Overall, the various disincentives described above, along with apprehensions about Egypt's political and economic stability, help to explain why investment in Egypt has been limited largely to location-specific industries such as petroleum, and quick-return industries such as banking and light consumer manufacturing, despite Egypt's attempts to attract long-term productive industries.

COSTA RICA'S BUSINESS AND INVESTMENT CLIMATE

Introduction

For the past three years, Costa Rica has been in the throes of an economic crisis that has threatened to rock this traditionally stable and unique Central American country. Growing foreign debt, compounded with a stagnant economy, high inflation, rising unemployment, and rapid depreciation of an overvalued currency precipitated a crisis beginning in mid-1981, when Costa Rica was unable to service its external debt obligations.

Costa Rica has traditionally shown remarkable progress vis-a-vis its neighbors, as well as other developing countries, achieving an average GDP growth rate for the 1960-80 period of almost six percent. This prosperity has been based on Costa Rica's good agricultural base, its homogenous and well-educated population, its long-standing democratic tradition, and its relatively even distribution of income.

However, serious structural problems such as government deficit spending, an unresponsive nationalized banking system, and a protected industrial sector have resulted in a misallocation of resources. Negative external factors, such as falling export prices, higher import prices, and the growing political unrest and economic instability of the region, combined in the late 1970s to reverse Costa Rica's forward momentum. Average annual GDP growth went from a high of 7.7 percent in 1977 to an estimated 6.0 percent decline in GDP in 1982. Export earnings, stalled by an overvalued currency, have failed to keep pace with an import bill bloated by high petroleum prices. To cover the worsening current-account deficit, the former government led by President Rodrigo Carazo escalated borrowing, mostly external, resulting in a 300 percent increase in credit to the government in 1979. The foreign debt burden is currently estimated at between \$3 billion and \$4 billion, creating a debt service ratio of about 25 percent. Costa Rica's expansionary monetary policy has caused inflation to spiral from 4.2 percent in 1977 to 37 percent in 1981 and almost 100 percent estimated for 1982.

In May 1982, President Luis Alberto Monge of the National Liberation Party took office and immediately enacted an austerity program to stabilize the economy and reduce the public-sector deficit, partly by increasing electricity, water and gasoline prices. Confidence in President Monge's economic program is building, primarily due to the results already achieved: rates of price inflation and currency devaluation eased significantly in late 1982; the trade balance has been turned around from a large deficit to a small surplus; and partial interest payments on the foreign debt were resumed in July 1982. However, the burgeoning public debt--still far from under control--threatens to undo any progress already made.

Costa Rica, a country of 2.4 million people with a population growth rate of 2.5 percent, has made major public investments in education, health, social welfare assistance, social security, and public services. These equity-oriented policies have developed a strong social and physical infrastructure, as reflected in such indicators as a 90 percent literacy rate, and are partly responsible for Costa Rica's tranquility. However, the costs have been high. It is uncertain what affect needed cuts in social welfare programs would have on political stability and social tensions. Thus far the government has been unwilling to institute any significant budget reductions.

The Costa Rican government is divided into three branches--executive, legislative, and judicial--with a President and two Vice Presidents elected on the same ticket for a single four-year term. The next election is in 1986. Unlike many of its neighbors, Costa Rica has no military, and instead relies on its 7,000 member Civil Guard for internal security as well as for external defense.

Costa Rica's Domestic Economic Performance

Costa Rica's GDP in 1980 amounted to $4.8 billion U.S. dollars, which reflected 5.8 percent average annual growth over the previous decade, despite the downward trend that began after 1977. From the 1977 high of 7.7 percent, GDP growth gradually declined in 1978 and 1979 as the economic crisis began to unfold, and them plummetted to 1.2 percent, -3.6 percent, and an estimated -6.0 percent for 1980, 1981, and 1982, respectively. On a per capita basis, GDP grew from $512 in 1960 to $1,730 in 1980.

Aside from adverse external factors, several domestic structural problems help explain Costa Rica's declining economic performance since the late 1970s. Since 1963, Costa Rica's economic development strategy has emphasized industrialization based on import substitution and participation in the Central American Common Market (CACM), while neglecting the traditional export-oriented agriculture sector. Although this strategy allowed a positive macroeconomic performance until 1977, it created a number of economic distortions. These include: 1) the continued dependence on a few traditional export commodities whose prices have gradually deteriorated; 2) the establishment of a relatively capital-intensive industry through incentives and steadily growing payroll levies; 3) the development of relatively inefficient industries due to protectionist trade restrictions; 4) the near exhaustion of import substitution opportunities; 5) the emphasis on industry at the expense of agriculture; 6) the heavy reliance on borrowed funds (often foreign) for investment capital as a result of government financial policies; and 7) a bias against exports through a previously overvalued exchange rate.

In addition, the national banking system, considered slow, bureaucratic and excessively conservative, has failed to attract internal savings and provide adequate financial intermediation. Since credit extended to the public sector has risen sharply-- up from 36 percent of new credit in 1978 to 64 percent in 1980--private sector borrowers have been caught in a credit squeeze, often forced to seek financing from external sources. As a result, inflation rates have become unmanageably high.

Reinforcing standard development trends, Costa Rica's import substitution policies have significantly changed the sectoral distribution of output between agriculture and manufacturing. Agriculture's share of GDP fell from 26.2 percent in 1960 to 17.7 percent in 1980, whereas manufacturing rose from 11.3 percent to 22.2 percent during the period. Agriculture's share of the labor force dropped from 51 percent in 1960 to 29 percent in 1980, while manufacturing's share only rose from 19 percent to 23 percent. The remaining share was accounted for by the rise in services' labor force from 30 percent in 1960 to 48 percent in 1980.

Agricultural policy has generally left production to the private sector, with intermittent forms of incentives, controls, protection and technical support provided by the government. Since the mid-1960s, attempts have been made to diversify Costa Rica's agricultural base through subsidies to sugar, cocoa and beef production. These efforts were aimed at reducing Costa Rica's traditional dependence on coffee [accounting for 90 percent of total exports in the 1950s and about 25 percent currently] and bananas. Whereas subsidized production credit has resulted in coffee production becoming for the most part a nationally-owned industry, cultivation of bananas has been largely in the hands of foreign interests, such as United Brands and Standard Fruit.

Although successive administrations have extended increasing support to the agriculture sector, industrial and urban interests have consistently received priority treatment at agriculture's expense. For example, the production of food crops (i.e., corn and beans) has suffered because of price controls. Similarly, protective tariffs have increased the cost of agricultural inputs, which along with price controls has caused deteriorating terms of trade for the agricultural sector.

Industrial sector development was advanced significantly by the creation in 1961 of CACM (Costa Rica joined in 1963), which stimulated both domestic and foreign investment by increasing the size of the market available to Costa Rican producers. The CACM was a particularly important stimulant for investments in light manufacturing industries and in tourism. Major manufacturers include processed foods, cement, fuel oil, textiles, tires, fertilizers, paints, pharmaceuticals and furniture. Expanding at an average rate of ten percent per year through 1977, the industrial sector has grown at consecutively smaller rates since that time, due to the high cost of import inputs and the contraction of local and CACM markets. The natural side effect of the import substitution policy has been basic distortions in the economy. While there are a large number of small and medium size firms, Costa Rica's industrial structure is highly concentrated with a few establishments (2 percent) generating the major share of employment (33 percent), output (44 percent of value added) and manufactured exports.

Although few mineral resources have been discovered to date, gold and small quantities of silver are mined. Substantial reserves of bauxite are being developed, and copper has been found in the Talamanca Hills on the Panamanian border. Clay, lime, and stone are also extracted. Hydroelectric power is also being expanded, in one instance to provide energy for aluminum smelting.

Government involvement in manufacturing activities was minimal until 1974 (two percent), when CODESA (a development bank initiative) was formed. Government enterprises in 1980 accounted for ten percent of manufacturing output. Through CODESA, the government nationalized the railroad and oil refinery, and entered fields which investors avoided, such as gasohol, aluminum production, and urban bus transport. Consequently, CODESA has become a holding company for mostly unprofitable ventures, and runs a huge annual deficit, financed by the national budget and the Central Bank. These losses affect the private sector by forcing firms to compete for credit that has been allocated increasingly towards the public sector by administrative fiat. CODESA has recently begun seeking private sector equity participation in various of its companies, as instructed by the government.

Another source of factor price distortion has been Costa Rica's regulation of prices for a range of goods and services deemed to be "basic needs" (i.e., food items, apparel, utilities and pharmaceutical products). In addition, minimum wage laws and maintenance of underpriced credit through low interest rates have contributed to the development of an excessively capital-intensive economy. While the government has eliminated some subsidies--those on transportation, utilities and fuel--the rapid increase in prices since 1979 has resulted in intensive pressure to increase minimum wages and to maintain price controls.

Often considered Costa Rica's single most important factor endowment, the labor force has experienced serious unemployment, growing to a level of 9.5 percent in 1982. This figure does not include visible and invisible underemployment, which is estimated at about 12 percent by the government. Compared to an historical range of four percent to six percent for the previous 20 years, unemployment alone could substantially increase social unrest.

Costa Rica's International Economic Performance

Despite Costa Rica's push for industrialization, over 60 percent of total exports are in the form of agricultural products. Coffee and bananas are the two largest foreign exchange earners. Other major agricultural exports include cocoa, sugar and beef. Depressed world prices for Costa Rica's principal exports, coffee and bananas (whose earnings have declined from $1.17 billion in 1981 to $880 million in 1982), have been a major contributor to Costa Rica's current economic crisis.

The manufacturing sector is a net user of foreign exchange. Costa Rica's import substitution policy has required the importation of raw materials and capital goods, which along with needed petroleum products have squeezed out imports of consumer goods (down to only 22 percent of the import bill).

Costa Rica's balance of trade gradually fell into deficit in the 1960s, and worsened in the 1970s as exports grew at an annual compounded rate of 15.9 percent and imports rose by 17 percent. These deficits were offset by foreign investment inflows until falling export prices, an increased oil bill and the continuously overvalued colon fundamentally undermined the trade balance. From 1977 to 1979, Costa Rica's oil bill more than doubled, while revenue from coffee exports dropped by 10.3 percent, even with an increased volume of 34.5 percent.

To meet rising current account deficits, reaching as high as $500 million in 1980, Costa Rica was forced to use its reserves and to increase external borrowing and refinancing. Foreign exchange limitations led to a de facto devaluation of the highly overvalued colon. Over the past three years, the colon has depreciated by 500 percent. While exports have decreased due to depressed external markets, the currency depreciation and austerity measures adopted by the Monge Administration have led to a major decrease in imports, about 32 percent in 1982. As a result, a small trade surplus was recorded in 1982.

Failure to bring public sector spending under control prompted the suspension of a three-year IMF agreement signed in June 1981. Growing payments problems in late 1980 and early 1981 caused external credit to be cut off, which forced the government into arrears in August 1981. Partial repayment of interest was resumed in July 1982. External debt servicing, which rose from 10 percent of total exports for 1970-77 to over 25 percent in 1980, continues to put enormous pressures on the economy. It is estimated that the total principal and interest due from the last quarter of 1981 through 1982, plus arrears, would amount to $927 million, almost equivalent to Costa Rica's total commodity export earnings in 1981--$964 million. Costa Rica's external debt--about $3 billion to $4 billion (with arrears of about $440 million)--is one of the highest per capita in the world.

The Monge Administration, which took office in May 1982, has actively sought to restructure the $1.1 billion debt owed to private creditors, and has negotiated with the IMF a $100 million standby credit, with the possibility of additional major credits. However, the public sector deficit again threatens to suspend future IMF dispursements under the recently negotiated standby arrangement. In addition, the U.S. has increased economic aid, even though Costa Rica has not resumed payment on previous U.S. loans.

Costa Rica's export promotion efforts could receive the extra stimulus needed by recent passage of the Caribbean Basin Initiative by Congress. Although already involved in the CACM free trade system with Nicaragua, Honduras, El Salvador, and Guatemala, which purchase most of Costa Rica's non-traditional exports, current political tension in the region has contracted these markets. Costs Rica's primary export markets, as shown in percentages of total exports in 1982, are the United States (34 percent), CACM (19 percent), and the Federal Republic of Germany (13 percent). Principal sources of imports are the United States (38 percent), CACM (12.6 percent), Venezuela (11.9 percent), Mexico (8.8 percent) and Japan (4.3 percent).

Investment Climate

Despite its location and its severe economic crisis, Costa Rica still offers favorable investment advantages and remains a relatively safe haven for foreign investment. While the crisis heightens the perception of potential political risk, it also creates favorable investment conditions such as reductions in local costs due to currency depreciation. In addition to its austerity policies, the government regards the revitalization of the private sector as necessary to bring the economy out of its current crisis. Foreign private investment is especially encouraged with various incentives. Foreigners, granted the same rights as Costa Rican citizens by constitutional guarantee, are permitted to undertake any legimate business activity with few restrictions. To simplify the often cumbersome bureaucratic procedures that potential investors have to undergo, the administration is undertaking a structural reorganization to create a central organization to assist foreign private investors.

The government particularly encourages foreign investment in light manufacturing, processed foods, agri-business and other sectors which use local raw materials, have a high value-added component, or have substantial export potential. In practice, any export-oriented investment which uses local natural resources will be welcome and may qualify for some tax incentives. One major fiscal disincentive is the very high corporate tax rates. Essential infrastructure sectors, such as utilities, railroads, petroleum refining and distribution, the communications media, as well as alcohol distilling and insurance are not open to private, direct foreign investment.

As a signatory to the General Treaty of Central American Economic Integration, one of the basic documents of CACM, Costa Rica offers tax exemptions, from three to ten years, depending on the category, to producers of industrial raw materials, capital goods, and consumer goods containing at least 50 percent Central American materials. Certain other goods not meeting the 50 percent test, as well as any industry or commerce that contributes to the balance of payments, are eligible for tax exemptions.

Costa Rica has a well-developed infrastructure of roads, ports, railroads, water and electric power. Above all, Costa Rica offers an educated and readily trainable labor force. Basically self-sufficient in electric power, Costa Rica has tapped only 10 percent of its hydroelectric potential. There are five major ports and newly-founded free trade zones on each coast.

The government's approach to foreign investment has been and will probably remain favorable to investors, although government priorities have resulted in some ad hoc shifts in the past. While nationalization of industries is not contemplated at the present, it has occurred three times in the past, always through a process of negotiation and fair compensation. If changes are made in present policy toward foreign investment, they would likely be geared toward keeping profits in Costa Rica, increasing employment and reducing dependence on the internal credit market.

The severe credit squeeze has virtually stopped new investment in Costa Rica. Only limited short-term credit is now available even for export-oriented industries. Private foreign investment, which fell from 45 percent of total private investment in 1976 to 15 percent in 1979, is expected to remain limited until the economy shows definite signs of stability. The passage of the Caribbean Basin Initiative could provide a stimulus for investment in export industries. In addition, the U.S. and

Costa Rican Governments negotiated a Bilateral Investment Treaty in January 1983, which will go into effect when it is signed and ratified by both parties.