The University of Michigan
CENTER FOR RESEARCH ON ECONOMIC DEVELOPMENT
Mailing Address: CRED, Lorch Hall, Ann Arbor, MI 48109-1220
Telephone: (313) 764-9490
Telex: 432-0815 Cable: CREDMICH

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A Review of "Promoting Private Investment" by The United States Council for International Business

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Promoting Private Investment
By the United States Council for International Business

I. Overview

The thesis of this paper, that foreign direct investment (fdi) is important to the development arsenal, is economically sound. But the key issue is not whether fdi is a good thing, but how it can be structured to be more politically palatable to LDC's. Foreign direct investment can take many forms (joint ventures, franchising, licensing, management contracts, turnkey operations, production sharing, and international subcontracting). Unfortunately, this paper does not explore these innovations. Instead, it seems to take the view that fdi will best be increased by more aggressive marketing by multilateral institutions -- rather than more innovative marketing.

Its basic recommendation, then, is that all major multilateral institutions and governments make fdi a higher priority. The paper does make some useful points, in particular when it considers the U.S. government's role in facilitating fdi (see section V). Where it considers the role for multilateral institutions, it sometimes makes statements that are politically naive. In general, the focus is too much on multilateral institutions (adding new overlays of international bureaucracy), and not enough on facilitating the private sector in its exploration of fdi.

II. Comprehensive Strategy

The paper begins with an articulation of the "comprehensive strategy" needed to promote fdi. This will require the intellectual participation of industrialized countries, developing countries, and intergovernmental organizations. In particular, the paper advocates the establishment of an international investment code. It also advocates the extension of the GATT to cover fdi, or failing this, the negotiation of an OECD code. While the

establishment of a general investmnt code is a worthy idea, it is less clear that LDC's -- even some industrialized countries -- will agree to binding conditions under which fdi may operate inside their borders.

III. Host Country Prerequisites to Attract FDI

The paper goes on to consider the conditions that attract fdi. These include favorable macroeconomic climates (positive real interest rates, a large domestic economy, sound exchange rates); and favorable investment climates (loose restrictions on the degree of foreign ownership, on the repatriation of profits). The paper refers to an interesting study conducted by the OECD that concluded that incentive programs have only a marginal effect on the decision to invest.

These points are followed by a list of the various forms fdi may take. Unfortunately, these forms are simply enumerated, and the issue is not developed.

IV. Role of Intergovernmental Organizations

In addition to the roles previously outlined for the GATT and the OECD, the paper advocates a fresh look at the 1967 Draft OECD Convention on the protection of foreign property. It also suggests that an UNCTAD code on technology transfers be brought to completion.

It then turns to the World Bank Group, making the point that the IFC, given its involvement in loan syndication, is well-placed to promote more fdi. The IMF can play a role by increasing its structural adjustment facility, and by promoting fdi in its structural adjustment packages. It advocates that the U.S. government play an active role in shaping the policies of MIGA. Like the IFC, MIGA is well-placed to facilitate greater fdi (through guarantees against noncommercial risk). Moreover it may be a far easier task to convert a private company to fdi than to convert many LDC's. It may be a more efficient use of resources to develop the linkages from this end.

V. Regional and Bilateral Arrangements

The final section of the paper is the most useful. Here the focus is no longer on multilateral institutions, but on bilateral trade agreements and bilateral foreign assistance. The paper suggests that the U.S. can learn from recent European Community conventions with former colonial and associated developing countries (eg. Lome III). Among the articles of such conventions are agreements to explore a wider range of fdi possibilities. More importantly, it notes the growth of bilateral investment treaties (BITS), of which 260 have been negotiated in he last 20 years, primarily by European countries. The U.S. has signed only 10 such BITS, and can learn much from the experiences of other such agreements.

Finally, the paper advocates greater U.S. government support in facilitating fdi. It notes USAID's role in promoting fdi through innovative initiatives such as the Joint Venture Feasibility Fund and Entrepreneurs International. The Overseas Private Investment Corporation (OPIC) provides a useful role in insuring for political risk. These are positive steps that the U.S. can take, which will require no persuasion, no negotiations with other governments. Moreover, they attack the fdi problem from the easier end (providing greater support to the private sector).

1212 Avenue of the Americas New York, New York 10036-1689
Telephone: 212 354 4480 Telex 820864

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PROMOTING PRIVATE INVESTMENT

POLICY STATEMENT

I. Introduction - The Role of FDI

This paper lays out the elements of a short-term and long-term strategy for stimulating foreign and domestic private investment in developing countries.

Foreign direct investment, while not a panacea, can and should play a significantly larger role than it does today in the transer of resources from the industrialized world to developing nations.

However, FDI can be an extremely useful tool for the expansion of world trade, domestic growth of economies, the transfer of technology and of management and marketing techniques. Moreover, the policies that will encourage FDI will also encourage greater domestic private investment in developing countries.

Foreign direct investment is a complex phenomenon; a combination of many, interrelated factors must be present to stimulate the flow in a particular direction. However, with the implementation of innovative strategies by the private sector and on the part of governments and international institutions, FDI could play a much greater role than at present in contributing to sustained growth in developing countries.

II. Comprehensive Strategy

What is needed is a comprehensive strategy to accelerate the flows of private investment. The strategy calls for interrelated actions on a wide range of fronts by industrialized countries, developing countries, and intergovernmental organizations.

Unlike the field of international trade, where the General Agreement on Tariffs and Trade (GATT) has provided rules of the game since its inception in 1947, the flows of foreign investment have not had a stabilizing set of uniform rules and practices. Several attempts have been made to negotiate international investment rules, starting

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with the aborted International Trade Organization under U.N. auspices in 1948. The Organization for Economic Cooperation and Development (OECD) took up the mantle in the 1960s with mixed results. The 1967 Draft OECD Convention on the Protection of Foreign Property (which was never ratified) and the 1976 Declaration on International Investment and Multinational Enterprises are notable examples of the OECD's work. In 1977 the U.N. Commission on Transnational Corporations (TNCs) started negotiations on a Code of Conduct to regulate the activities of TNCs in the investment process. These negotiations have been stalemated for several years. The U.S. and other governments should work towards the implementation of a set of international investment rules. In the longer term, this could be done by expanding GATT disciplines to cover investment as well as trade, and by adopting a binding OECD treaty on investment open to developing, as well as developed countries.

Given the widely differing views of the industrialized and developing countries, as well as those of the Communist countries, on the basic principles to govern foreign investment, it is obvious that achieving an investment regime along the lines of the GATT rules for trade will remain a long-term goal. In the meantime, a number of measures should be taken which will contribute to the development of internationally recognized investment principles--the building blocks of the international investment regime that is our ultimate goal.

Our strategy, therefore, calls for a mix of policies to achieve our long-term aims as follows:

Governments, including the United States and intergovernmental organizations, must consider policies in a more coordinated manner and should organize their administrative agencies to reflect this reality. Some progress in this direction has been made linking trade, monetary and investment policies. Recent Economic Summit meetings have recognized this point. In the Uruguay Round, parties to the GATT have extended their negotiations to investment measures. The OECD and the ILO, particularly in the context of their work on structural adjustment, are also involved. The 1985 Baker Plan, and debt/equity and debt/bond swaps are policies that cross over traditional boundaries and which are worthy of continued support with appropriate modifications in the light of experience.

The closer coordination of investment and development policies and the joint consideration of official development finance and private flows of capital to developing countries is equally imperative, since no single source can provide the needed funds to restore growth in the economies of developing countries.

III. Host Country Prerequisites to Attract FDI

The U.S. and other industrialized governments should work both bilaterally and multilaterally to encourage adoption by developing countries of policies which will improve investment conditions for both

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local and foreign investors. The same policies that will encourage greater domestic private investment and contribute to the alleviation of the capital flight problem will heighten the confidence of international investors.

The concept of structural adjustment to promote economic growth, as contained in the reports of recent high-level meetings of the ILO and the OECD, is as relevant to the economies of developing countries as to those of industrialized countries. Governments which have conferred on these reports should use their influence to encourage developing countries to adopt the policies recommended in them, for macroeconomic (monetary, fiscal) and structural (labor, industrial) adjustment.

A. Viable Macroeconomic Conditions

First and foremost of the conditions necessary to attract viable foreign investments in developing countries are favorable macroeconomic factors, such as the size of the domestic market, the potential for local production, natural resource endowment, and a stable and viable economy with realistic exchange rates, positive real interest rates, curbs on excessive inflation, and the reduction of budget deficits. Specific incentives or measures to improve the investment climate will not induce investment if the macroeconomic mix is wrong.

B. Positive Investment Climate

There is a growing recognition by developing countries that the reduction of regulations restricting FDI is important. Factors generally included in the determination of an investment climate are regulations on entry, degree of foreign ownership, repatriation of profits and capital, the extension of domestic credit, import restrictions, and export requirements. Although there are differing views as to the importance of investment climate to the investment equation, a hostile climate tends to deter foreign investment from entering.

1. Privatisation

Privatisation is particularly crucial in certain sectors requiring advanced technologies and large amounts of capital. These would include, for example, information technology, transportation and power. Development in these areas would benefit greatly from the capital and technology to which international investors have access. Moreover, they are critical to creating environment conducive to further investment and growth. Current exports to open these areas should be applauded, and encouraged.

2. Practical Measures to Attract FDI

A recent study of the International Chamber of Commerce stressed the practical measures which developing countries should take to attract and retain foreign business operations, including a stable, but flexible legisltive framework, a tax system that is clear, precise and non-discriminatory as between foreign and domestic companies, an improved educational system to ensure an adequate supply of skilled labor, a modern advertising and distribution regime, and an adequate system for the protection of intellectual property.

3. Incentives and Disincentives

Recent studies carried out by the OECD concluded that incentive programs have a minimal influence on the basic decision to invest internationally, but, that when effective, may play a role in the choice of a location or in the timing of an investment. More important as determinants are market conditions, political stability and regulatory predictability.

However, when tied to performance requirements, as is often the case, they can operate as powerful disincentives.

C. New Forms of FDI

Foreign direct investment has traditionally been considered a 100 percent or majority-owned situation. However, since the 1960s, new forms of investment have arisen to complement or supplant traditional investment. These new forms include joint ventures, franchising, licensing agreements, management contracts, turnkey contracts, production sharing and international subcontracting. It is obvious that to attract the maximum flows of FDI, a host country should be liberal in its attitude toward traditional and new forms of investment. The fewer the limitations on any particular form of investment, the more likely that flows will be stimulated.

IV. Role of Intergovernmental Organizations on Investment Issues

The U.S. Government should give full support to the work of a number of intergovernmental and regional organizations on investment issues, namely:

A. OECD

The work of the OECD Committee on Investment and Multilateral Enterprises (CIME) on promoting private investment to developing countries should be intensified. The type of principles to be developed are similar to those contained in the 1967 Draft OECD Convention on the Protection of Foreign Property (which was never

ratified), but which nevertheless has served as a model for the majority of bilateral investment promotion and protection treaties that have been negotiated between developed and developing countries. Discussions of such principles could provide agenda items for Roundtables to follow up on the 1986 OECD Roundtable in Berlin on investment in developing countries. Planning for the proposed Roundtable in Tokyo the end of 1988 or early 1989 should be stepped up.

The 1976 Declaration on International Investment and Multinational Enterprises is scheduled for a review by the OECD Governments in 1990. The U.S. initiative to strengthen the National Treatment portion of the Declaration is gaining support. However, this is just a first step. Governments should be urged to take a fresh look at the 1976 Convention with a view to its adoption as a binding treaty, open to developing countries as well as to industrialized countries.

The OECD Development Assistance Committee (DAC) is planning to examine the role of development assistance in strengthening the private sector in LDC and encouraging FDI. The U.S. is relatively advanced among its DAC partners in incorporation of private sector facilitation into its aid policies and programs. The U.S. should work within DAC to get the other OECD countries to do likewise and to cooperate in using aid to foster private sector development.

B. GATT

In the Uruguay Round, the GATT parties have for the first time extended their negotiations to cover trade-related aspects of investment measures. However, the application of GATT principles to a broader range of investment issues would substantially increase investor confidence in international investment. The U.S. has taken the lead on this issue. It should continue to press for a GATT agreement on the whole range of investment measures which distort international flows of goods, services and capital and which discourage investment abroad.

C. The World Bank Group - The Centerpiece of Increased Cooperation

1. The International Bank for Reconstruction and Development (IBRD) and its affiliate, the International Finance Corporation (IFC), are particularly well placed to provide the centerpiece for fresh initiatives for the promotion of FDI. According to the Bank's charter, it must lend only for productive purposes and must stimulate economic growth in the developing countries where it lends. During the past three years, the Executive Directors of the Bank have given much attention to the Bank's new cofinancing instruments aimed at assisting its borrowers to mobilize finance from commercial sources; to Secretary Baker's debt and investment initiative; to the examination of the debt problem and growth; and to ensuring food security in the developing world, among other issues. Given the relevance of its lending activities to stimulating investment and growth in developing countries

and the high regard the World Bank enjoys in most quarters, the Bank is an ideal instrument for substantially increased financial support from member nations.

2. The International Finance Corporation (IFC)

The IFC, which is affiliated with the World Bank, but which legally and financially is a separate entity, was established in 1956 to assist the economic development of developing countries by promoting growth in the private sector of their economies and helping to mobilize domestic and foreign capital for this purpose. The IFC supplements the activities of the IBRD by providing private business equity and loans without government guarantees in whatever form and combination are best suited to the particular project. The IFC's capability to raise investor confidence in a project and to help all the participants to arrive at mutually satisfactory investment arrangements make it an ideal instrument for the promotion of FDI. With a total authorized share capital of $1.3 billion in 1986, it can be seen that the magnitudes of financial resources are only a small fraction of what is needed. The breadth of its techniques, its innovativeness, and its flexibility should be built on. Increased strong financial support by member governments is essential.

3. IMF

The IMF is charged with a wide range of responsibilities relating to the international monetary system and the correction of countries' balance of payments difficulties. The IMF has provided critical policy advice to developing countries. However, it has focused on monetary, fiscal and exchange rate policies. The U.S. has urged that it work more closely with the World Bank and place higher priority on structural policies (e.g., tax and labor market reform) to ensure that its programs are growth oriented.

In 1986, the IMF Executive Board established a new "structural adjustment facility" to provide concessional balance of payments assistance, in cooperation with the World Bank, to low-income countries undertaking comprehensive efforts to correct protracted balance of payments problems. The facility has several innovative features. Arrangements under the facility require a three-year policy framework that explicitly incorporates the structural policy elements of a country's reform program. Collaboration with the World Bank is formalized; joint participation in and review of the policy framework paper is required.

This facility combines the respective strengths of the IMF and the World Bank and helps ensure that policies are devised which would facilitate growth and increased private investment. Governments should urge the IMF to step up its works on the structural adjustment facility.

Although the World Bank Group is the most relevant world-wide IGO to strengthen private investment programs, greater coordination of investment policies in the IMF, IBRD, IFC, as well as the MIGA, when it becomes effective, is imperative. This is particularly true with respect to the IMF/IBRD adjustment programs, the IFC's Foreign Investment Advisory Service (FIAS), and the MIGA's new role in providing investment promotion, advisory and technical assistance programs.

D. MIGA

The Multilateral Investment Guarantee Agency (MIGA), established an an independent agency under the aegis of the World Bank, is designed to foster the flow of direct investments to and among its developing member countries by issuing guarantees against noncommercial risks (transfer of earnings and capital, expropriation, war and civil disturbance, and breach of contract), by facilitating intergovernmental consultations on investment policies and by carrying out investment promotion, advisory, and technical assistance programs. As such, MIGA is designed to complement the activities of the World Bank, the International Finance Corporation, national investment insurance programs, private insurance and other agencies in the encouragement of increased international investment in developing member countries.

A high priority for the business community is the ratification of the MIGA by the requisite number of countries, including the U.S., and its entry in force by the April 30, 1988 deadline for this purpose set by the World Bank Governors.

E. The United Nations

The U.N. Code on Transnational Corporations (TNCs), which began its negotiations in the 1970s in an atmosphere of heated rhetoric and distrust for the motives of TNCs in the investment process, is now seen by the U.N. Secretariat and many developing country delegations as a potential vehicle for the promotion of FDI, in addition to a means of regulating the activities of TNCs. Action to resolve the remaining differences on the Code has been stalled for several years, primarily over the section on responsibilities of governments toward TNCs, which is so crucial to the Code's acceptance by most industrialized countries and by the business community. Recently, there have arisen doubts by some industrialized countries and by the international business community that a proper balance between the rights of TNCs and the rights of governments can be struck in the present version of the Code based on concepts over ten years old at a time when FDI was

discredited.

Similarly, the long-term efforts to negotiate a Code of Conduct on the Transfer of Technology in the U.N. Conference on Trade and Development (UNCTAD) have been stalemated for several years. As in the case of the U.N. Code on TNCs, basic differences still exist in the areas of applicable law, dispute settlement, parent-subsidiary relationships, scope and legal nature of the Code.

The U.N. also undertakes investment promotion activities, through the U.N. Centre, the UNCTAD and the U.N. Industrial Development Organization (UNIDO), which has established seven investment promotion services in DAC member countries, designed to strengthen ties between home and host countries in industrial cooperation, the promotion of investment projection and the transfer of technology.

V. Regional and Bilateral Arrangements

A. E.C. - Lome III

The most evolved of the regional arrangements that promote FDI to developing countries has been inspired by the European Communities. The latest in a series of conventions agreed to by the E.C. and their former colonial and associated developing countries in Africa, the Caribbean and Pacific regions (Lome III) was signed in December 1984 and assigns greater significance to investment promotion and protection than its predecessors. The signatories have agreed to produce a number of studies aimed at improving the investment climate and to cover a range of investment promotion policies. The European Community will continue to play an internationally important role in promoting private investments to developing countries. The U.S. should support the widespread adoption of the innovative techniques employed by the E.C.

B. Bilateral Investment Treaties (BITS)

Effective action to protect and promote FDI has resulted from the extensive network of Bilateral Investment Treaties between developed and developing countries, among developing countries themselves, with Eastern Bloc nations, and China over the past 20 years. European countries, particularly the Federal Republic of Germany, the United Kingdom, and Switzerland, have negotiated over 260 of these treaties. The United States, a relative newcomer to this technique of protection of foreign investment, now has signed 10 BITS, which are still before the Congress awaiting ratification. The U.S. Government and the business community should continue to urge the ratification of these treaties as an essential element in the promotion of foreign investment abroad. The U.S. Government should accelerate negotiation of BITS and should emphasize coverage with larger countries and with countries in the Asian-Pacific region.

C. Bilateral Foreign Assistance Program

Additional stimuli to foreign investment are being made by bilateral foreign assistance programs that promote private sector activities. The U.S. Agency for International Development (AID), in addition to setting up a separate Bureau for Private Enterprise, has been giving increased attention to private sector programs in its Regional Bureaus. Such innovative initiatives with the private sector, such as the Joint Venture Feasibility Fund and Entrepreneurs International, to name only two, are examples of this trend and are to be commended. Much more could be done in this field and the business community should urge the next administration to step up the involvement of the private sector in its overall development plans.

Another important U.S. agency promoting overseas private investment is the Overseas Private Investment Corporation (OPIC). In addition to providing political risk insurance for U.S. private investments in more than 100 developing countries, OPIC finances projects sponsored by eligible U.S. investors in those countries. The business community should support OPIC's proposals for reauthorization in 1988. Its present Congressional authorization expires September 30, 1988.

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