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**TRADE AND DEVELOPMENT BOARD
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Expert Meeting on the Impact of FDI Policies on
Industrialization, Local Entrepreneurship and the
Development of Supply Capacity

Geneva, 5–7 November 2001
Agenda item 3

**THE IMPACT OF FDI POLICIES ON INDUSTRIALIZATION, LOCAL
ENTREPRENEURSHIP AND THE DEVELOPMENT OF SUPPLY
CAPACITY OF DEVELOPING COUNTRIES, IN PARTICULAR
THE LEAST DEVELOPED COUNTRIES**

Outcome of the Expert Meeting

1. The Expert Meeting on the Impact of FDI Policies on Industrialization, Local Entrepreneurship and the Development of Supply Capacity examined the policy issues related to: (a) the link between foreign direct investment (FDI) and industrialization, export competitiveness and development of supply capacity; (b) FDI promotion in the context of development strategies; (c) specific instruments and tools for FDI targeting; and (d) the promotion of backward linkages to support local entrepreneurship and development of supply capacity.

2. The experts noted that:

- (a) Most Governments acknowledge today that FDI can provide important benefits to host countries. It is clear that, in some countries and under

certain circumstances, FDI can help enhance export competitiveness and support industrialization strategies. The extent to which FDI contributes to these goals depends on many factors, including the corporate strategies that drive the FDI, as well as the degree of leverage achieved by policy makers and firms in the host economy from the linkages established. Benefits are not automatic, and countries need to create the appropriate conditions for the realization of the potential benefits.

- (b) Increasingly, in a globalizing world, transnational corporations are playing a decisive role in the global distribution of production and trade. In many of the developing countries that have had the greatest increases in their share of world exports of manufactures, attracting the right type of FDI has been central to their success.
- (c) The policy issues confronting developing countries that are searching for ways to use FDI as a means of boosting their export competitiveness vary, depending on their level of development, the sectors targeted and the resources available. However, all countries need to define from the outset clear policy objectives and to establish an FDI promotion framework consistent with each country's capacities and opportunities. Policies play an important role not only in attracting the kind of FDI which helps to develop industries that correspond to, and utilize, the dynamic comparative advantage of host countries, but also in spreading the benefits derived from FDI through linkages with domestic enterprises, thereby enhancing their supply capacity and eventually providing them with an opportunity to become global suppliers.

3. On the basis of the exchanges of experience during the Expert Meeting, some elements of best practice in the design of FDI promotion policies and policies to promote backward linkages could be considered.

4. First, there is a need to achieve political stability and a favourable environment for private sector activities, which may involve simply relaxing excessive restrictions, introducing new laws and regulations, or reinterpreting existing ones that can facilitate business.

5. A targeted FDI promotion approach would imply:

- (a) A focus on a few competitive sectors and industries;
- (b) A matching of countries' advantages with investors' interests;
- (c) An effort to create value added and leverage through foreign investment.

6. A targeted approach is an ongoing process and should develop with countries' evolving objectives and advantages.

7. Targeted companies could be those which:

- (a) Already have a presence in the host economy;
- (b) Are part of the supply chain;
- (c) Are users of countries' own resources, including raw materials and human skills;
- (d) Are active in strong production sectors with growth opportunities;
- (e) Help to establish new core competencies.

8. The tools to target investment have evolved, from cost reduction tools to differentiation and specialization. Government incentives, including tax incentives, can play a role. The tools often found to be effective include:

- (a) Clusters;
- (b) Public–private partnerships;
- (c) Alliances;
- (d) Aftercare for existing investors;
- (e) Subnational agglomeration.

9. In many countries, clustering has become an important targeting mechanism. It sometimes involves using or establishing research and development facilities, a network of small and medium-sized enterprises (SMEs) and a good public utilities infrastructure.

10. Belonging to a preferential trade area or having access to larger markets can be an advantage in attracting FDI.

11. Consideration could be given to promoting an efficient linkage programme which would take into account the following aspects:

- (a) The need for matchmaking to be complemented by measures to upgrade local supply capacity;

- (b) The need for supplier development efforts to be selective and target SMEs that show the greatest potential for growth;
- (c) Cooperation and coordination among the various government agencies;
- (d) Efforts to make SME development tally with FDI policies;
- (e) Reliance on the best business service providers, whether public or private;
- (f) The need for measures to be context-specific, and appropriate to the circumstances of each country or subnational location.

A. Governments

12. Governments are encouraged to consider cost-efficient ways of promoting FDI policies that are consistent with their country's overall development objectives and industrialization strategies, fully involving the private sector and reconciling foreign investors' motives with the country's priorities. While government leadership in providing a clear vision of a development strategy is the starting point, a public–private sector partnership is both helpful and necessary during the implementation stages.

13. Coordination among government agencies and departments, and a simplified institutional setting consisting of a lead agency for FDI promotion, are also highly recommended.

14. A targeted approach is recommended in designing FDI promotion policies, as it represents the most efficient use of limited resources, offers the best prospects for success, and helps to achieve strategic goals.

15. To increase the beneficial leverage of FDI on the host economy, Governments need to pay special attention to developing local supplier programmes, and to upgrading the technology and capacity of local suppliers.

16. Governments should examine the key elements of a linkage promotion programme, as summarized in the following steps:

- (a) Setting the policy objectives, in line with the country's overall development strategy;

- (b) Identifying the targets of the programme: selection of industries, foreign affiliates and domestic firms;
- (c) Identifying the specific measures to be adopted, in terms of information and matchmaking, technology and technical assistance, training and provision of finance;
- (d) Setting up an institutional and administrative framework to implement and monitor the programme.

17. It was suggested by some experts that developing countries should accelerate the privatization of the electricity, water and telecommunications sectors with complete transparency.

18. Home countries should share experiences in targeting and linkage promotion, and assist in this respect.

19. Improved access to developed country markets, especially for products from the least developed countries and low-income countries, can help those countries to attract FDI.

20. Home countries are also encouraged to provide financial assistance to developing countries, particularly those with limited resources, for the establishment of an appropriate framework for FDI promotion and linkage development.

21. Outward FDI agencies in developed countries could serve as vehicles for supporting FDI in developing countries, for example by liaising with investment promotion agencies in those countries and disseminating information.

B. The international community

22. International institutions dealing with FDI should assist developing countries and countries in transition in setting up an appropriate institutional framework for FDI policies and targeting, including the formation of clusters.

23. Cooperation and coordination among United Nations agencies and other relevant institutions on these issues are desirable.

24. The international community should assist the least developed countries in building and improving the infrastructure necessary for attracting FDI.

C. UNCTAD

25. UNCTAD should:

- (a) Continue to analyse the international systems of production, by sector and industry, and make this information available to member countries;
- (b) Assist developing countries in assessing their existing capabilities in order to help them define policy goals in line with their competitive situation in the international market;
- (c) Help developing countries to design, implement and monitor FDI targeting and linkage programmes consistent with their industrialization and development strategies.