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PART THREE
PROMOTING EXPORT-ORIENTED FDI

Chapter VIII
Targeted Promotion

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CHAPTER VIII

TARGETED PROMOTION

A. Targeting export-oriented FDI

Investment promotion can play an important role in the process of attracting export-oriented FDI in line with a country's development objectives. It covers a range of activities, including investment generation (e.g. image-building, general marketing, investor targeting), investment facilitation, aftercare services and policy advocacy to enhance the competitiveness of a location (Wells and Wint, 1990; Wells, 1999; Loewendahl, 2001a). This section addresses one of the key motives for Governments to engage in investment promotion: to remedy inefficiencies in the market for information. No matter how competitive a host location is, it will not attract export-oriented FDI unless investors are aware of the opportunities it offers.

As of today, the majority of countries have already moved from the *first generation* of investment promotion – which mainly involves the opening up of an economy to FDI – to the *second generation*, in which a Government decides to "market" its location actively, notably by setting up an investment promotion agency (IPA) (*WIR01*). The number of IPAs increased substantially in the 1990s: currently there are over 160 national IPAs and well over 250 sub-national ones (UNCTAD, 2002d). To increase the efficiency of investment generation and, in particular, to enhance the chances of attracting export-oriented FDI, a number of IPAs go further and utilize at least part of their FDI promotion resources for investor targeting. It is this *third generation* of more focused promotion strategies that is discussed in this section, with special emphasis on attracting export-oriented FDI. Third-generation promotion can be an effective policy tool, but it is not an easy task and involves certain risks. These are addressed specifically at the end of this section. Other aspects of investment promotion, including investment facilitation, aftercare services and policy advocacy will be discussed in subsequent sections.

1. Why target?

Targeting can be defined in different ways. In principle, it involves the focusing of promotional resources on attracting a defined sub-set of FDI flows, rather than FDI in general. Targeting is by no means a new phenomenon. Some countries, notably Singapore (box VIII.1), Ireland, the Netherlands and regions of the United Kingdom have practised it for some time, with much success.[1] However, it is only recently that targeting has become a more widely accepted tool among IPAs. Costa Rica is perhaps the best-known recent example in the developing world. Among LDCs, the IPAs of Bangladesh, the United Republic of Tanzania and Uganda, for example, have all developed investor-targeting strategies. Why have they done so?

First and foremost, a targeted approach can help countries achieve strategic objectives related to such aspects as employment, technology transfer, exports and cluster development, in line with their overall development strategies, especially when the attraction of export-oriented FDI is seen as an integral part of such strategies. Effective targeting involves a comprehensive approach to attracting investment that can contribute to development and enhance the competitiveness of a location. It also requires the adoption of government policies that underpin the specific marketing activities and a coordination of the relevant government agencies, including the IPA, in order to define investment priorities and the package of advantages offered in the framework of an overall development strategy.

A second reason for engaging in investor targeting to attract export-oriented FDI (other than resource-seeking FDI) is the increased competition for this kind of investment. Because TNCs typically consider

Box VIII.1. Singapore: an early mover in targeting export-oriented FDI

Singapore's successful multi-decade programme of targeting export-oriented FDI traces its origins to the late 1960s. After independence in 1965, Singapore realized that a development strategy of import-substitution industrialization, with FDI attraction focusing on market-seeking FDI, would not be a recipe for success. As part of an investment attraction strategy targeting export-oriented FDI, the Government set up the Economic Development Board (EDB) and gave it significant financial resources (corresponding to more than 4 per cent of GDP) to recruit qualified and well-paid professional staff to implement a strategy of attracting export-oriented FDI. The EDB became a "one-stop-shop" with the authority to coordinate all activities related to industrial competitiveness and FDI. This involves, among other things, policy formulation, the provision of incentives, and the creation of industrial estates to guide foreign investors into targeted activities.

The breakthrough came when Texas Instruments, after four months of discussions with the EDB, set up a semiconductor plant in the country in 1968. Texas Instruments' decision sent a signal to other electronics companies to consider Singapore as an investment location. By the end of the 1990s, there were more than 50 companies involved in the Singapore semiconductor industry, most of which were foreign-owned, employing some 21,000 staff. As the economy developed and wages increased, the EDB has gradually shifted its focus towards more sophisticated activities. More recently, special programmes (including designated incentive packages) have been launched to make Singapore an attractive base for regional marketing, distribution and service, and for regional headquarters. These targeting efforts have been complemented by various initiatives to enhance the availability of highly skilled labour and technological capabilities.

Sources: UNCTAD, based on Yew, 2000; Te Velde 2001; Lall, 2000a; Mathews, 1999.

a broader set of potential investment locations for export-oriented FDI, the need for a focused approach is particularly relevant. Investment promotion strategies need to reflect the changing corporate strategies that are driving firms to adopt geographically and functionally more specialized production systems (chapter II). It is no coincidence that many of the countries most successful in targeting are relatively small. Larger economies, such as Brazil, China, India and Mexico, may benefit both from being better known to foreign investors and from offering a substantial domestic market, which has the advantage of adding economies of scale to the production for export. For smaller and less well-known economies, targeting is more important to attract export-oriented FDI (Wells, 1999). This is not to say that relatively large countries do not use targeting too. However, it is often the case, as in the United Kingdom, the United States and India, for example, that the actual targeting is undertaken in such countries primarily at the sub-national level.

A third reason relates to cost-effectiveness. A focused approach to attract export-oriented investment is likely to be less costly, vis-à-vis the results achieved, than one in which an IPA attempts to attract new investment in a more ad hoc fashion. Many IPAs have realized that general image-building, involving advertising and participation in trade fairs, can be a waste of resources unless it is done as part of a well-defined strategy to attract a specific kind of FDI. There are of course costs associated with investor targeting. In fact, some of the IPAs that have been practising targeting for a long time – such as those in Ireland and Singapore – have had very large budgets at their disposal. However, there does not appear to be a close correlation between the size of a budget and the share devoted to targeting. The point is rather that the more targeted the effort, the greater the chances that the information provided is actually relevant to the recipients' decision-making. As the experience of Kyrgyzstan shows, a targeted effort can lead to results even with limited resources and under less than attractive conditions (box VIII.2).

2. What to target?

Once an IPA has decided to use targeting as part of its strategy to attract export-oriented FDI, the next challenge is to determine what industries, activities, countries, companies and, ultimately, individual managers should be targeted. The starting point for the selection process is a careful assessment of the strengths of a location – a country or a part of it – as a base for export production.

Box VIII.2. Targeting investors in a specific niche: sun-dried tomatoes in Kyrgyzstan

Being a small, poor and land-locked country, Kyrgyzstan has a difficult starting position for attracting export-oriented activities. To compound the problems in attracting FDI, all investment incentives had been eliminated to increase the tax base. Through technical assistance projects, Goscominvest, the IPA, developed a first-class website and good promotional materials. Despite these initiatives, it was not "on the radar screen" of most foreign investors and had insufficient funding for outbound missions, advertisements in business publications and broad-based image-building. In response to these problems, it developed an investor-targeting strategy. Interestingly, even though Kyrgyzstan had a comparative advantage in such industries as meat and wool production, attracting FDI to these industries was deemed to be impractical for various reasons.

Vegetables faced a somewhat different problem. Despite limited arable land, vegetables produced in the southern valley of Kyrgyzstan are of high quality. An expert from the Food and Agriculture Organization of the United Nations (FAO) had evaluated the country's tomatoes as the most nutritious and best-tasting of all the countries studied by the FAO. Still, exporting to neighbouring Uzbekistan was impossible because of trade restrictions and a dual exchange-rate system. Transport costs and long transport routes by land foreclosed markets in the Russian Federation and Europe for fresh produce, except by air freight at a considerable cost. The use of poor-quality tinplate for canning, and glass bottles, prohibited exports of processed vegetable products. Thus, even though high-quality tomatoes sold for 4 cents a kilo in the market, this comparative advantage could not be translated into competitive advantage on export markets.

The project finally identified two agricultural products with investment potential: sun-dried tomatoes and wild mountain herbs that grew in abundance throughout Kyrgyzstan's mountain ranges. Goscominvest staff sent information on the investment opportunities, such as supply availability and comparative costs, to the specific companies identified as potential investors in the Investor Roadmap project via the Internet. Four companies responded favourably and visited Kyrgyzstan. Within six months, investment commitments had been secured from two companies based in Europe totalling several hundred thousand dollars.

Source: UNCTAD.

a. Identifying comparative advantages

The purpose of this assessment is to benchmark a location against competing ones to identify its main relative strengths and weaknesses. This is important to increase the chance that efforts to promote export-oriented FDI result in development gains, as well as to reduce the risk of promoting areas in which a country is unlikely to be successful in attracting FDI. Countries with better knowledge of their comparative situation stand a better chance of developing a competitive "package" that can match the assets controlled by foreign investors. Such an assessment also helps Governments to identify areas in which policy changes may be needed to make the business environment more attractive and more conducive to benefiting from export-oriented FDI. However, to identify opportunities to attract or upgrade export-oriented FDI, countries also need to take into account the key factors affecting the location of production in different industries. This assessment can be undertaken at the national, sub-national, industry, activity or even project level. The discussion here concentrates mainly on the national level.[2]

A natural starting point for assessing a country's strengths as a base for export-oriented production is to look at the prevailing patterns of exports and imports and the prevailing industry structure. Trade analysis can help identify the comparative advantage of a country. A number of tools developed by the International Trade Centre (www.intracen.org) allow countries not only to assess where their revealed comparative advantages lie, but also which other countries are competing in key product areas, where there is demand for particular products and which product categories are among the most dynamic in world trade (box VIII.3).[3]

Obviously, trade analysis is primarily related to historical performance rather than the potential of a country. Countries also need to consider FDI-related export opportunities in the areas of services and for products that are "up-and-coming" but have not yet been reflected in trade statistics. For the latter, trade analysis can be complemented with an analysis of industry structure, as this may indicate areas in which a country's export potential has not been

Box VIII.3. Trade analysis tools for investment targeting

The International Trade Centre (ITC) has recently developed a number of tools that may be helpful in identifying industries and markets to target for export-oriented FDI. Some of these are available free of charge, whereas others can be subscribed to. According to a joint study by the ITC and the Multilateral Investment Guarantee Agency (MIGA), these tools have recently helped identify such opportunities in six African countries.[a]

Country Maps tools provide useful inputs for assessing comparative and competitive advantage. They are available at www.intracen.org under "Country approach". Two of the tools are of particular interest in assessing trade performance. The *Trade Performance Index* helps to assess trade performance at the country level by providing a general macroeconomic profile and ranking for each industry; essentially a static view of a country's recent export performance. The Index covers 184 countries and 15 different industries. The second tool, the *National Export Performance* provides an overview of the export performance and specialization of countries in terms of the dynamics of international demand. This tool provides a chart divided into four quadrants, with different interpretations in terms of trade promotion and attractiveness for FDI targeted at international markets (see box figure VIII.3.1 for the case of Mozambique). Of particular interest is the so-called "champion industries" quadrant, which displays high-growth sectors in which the country has proven its international competitiveness. Efforts to attract FDI for these products are less risky, as they are national success stories that can serve as reference points. Promotional efforts for these products should aim at broadening the supply capacity. Industries located in the "underachievers" quadrant are also interesting; since the demand side prospects are good, there may be scope for attracting export-oriented FDI into these industries.

Interactive Trade Maps allow users to analyse trade flows and patterns of protection for over 180 countries and territories. This analysis can contribute to the identification of those industries that could attract FDI in a given country and the markets to target. This tool provides on line access to the world's largest trade database and to market-access data obtained from the UNCTAD's Trade Analysis and Information System (TRAINS) database in an interactive environment. It is available on a subscription basis (see mas@intracen.org) and is largely used by trade support institutions, which can customize the application. It covers more than 95 per cent of world trade.

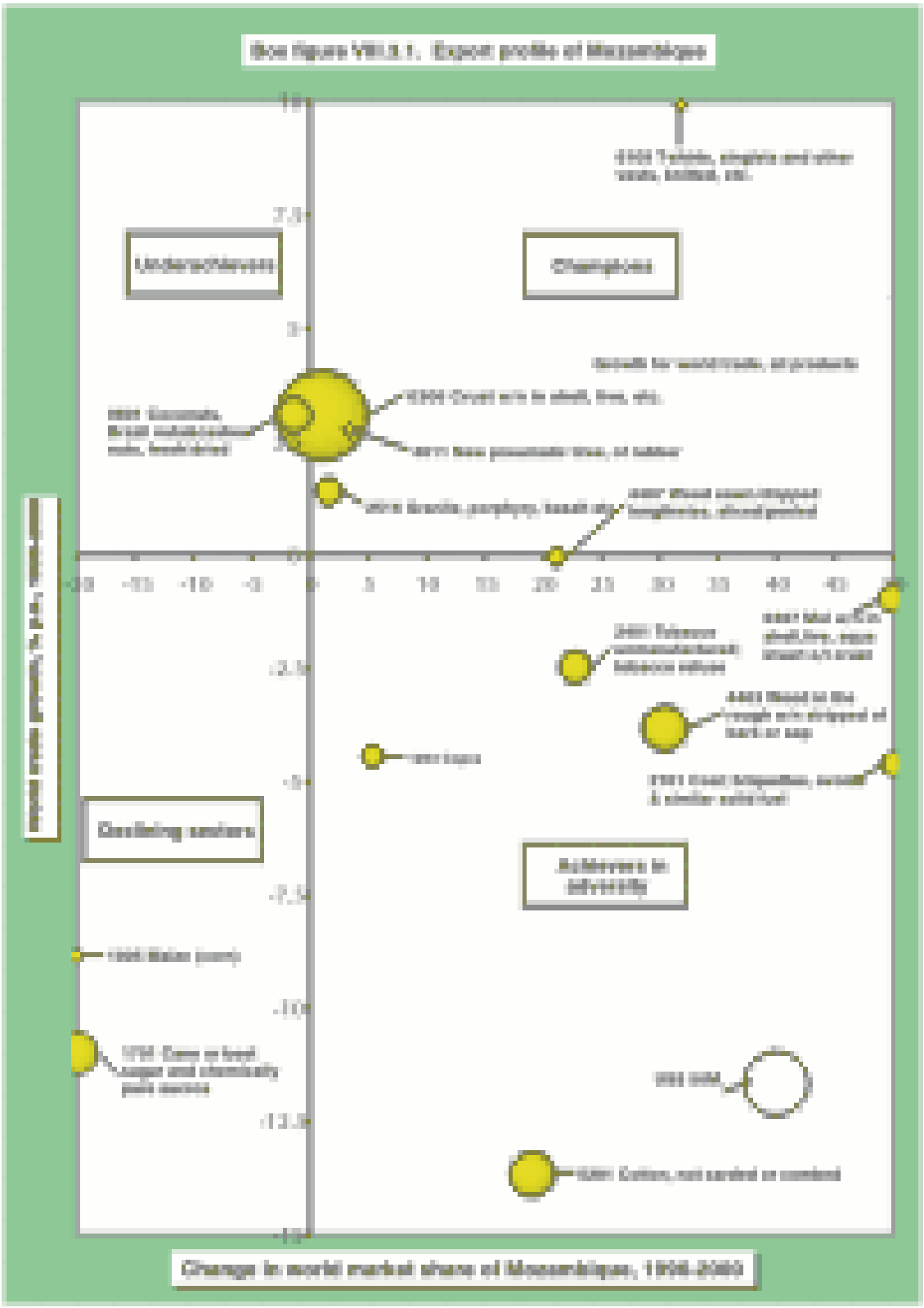
Market Access Map is a bilateral database of over 30 gigabytes on market-access information. It allows an examination of market-access barriers between any pair of countries included in the database at differing levels of aggregation, ranging from the national tariff line level to total trade. At present, this database covers about 150 countries and territories on the import side and about 200 countries and territories on the export side, and was developed by ITC in collaboration with the Centre d'Etudes Prospectives et d'Informations Internationales (www.cepii.fr) and UNCTAD-TRAINS. It integrates the major instruments of protection (ad-valorem and specific duties, prohibitions, tariff quotas and anti-dumping duties) that are converted into ad-valorem equivalents. For investment targeting, this tool is particularly useful in identifying industries and markets where target countries benefit from a significant preferential margin over potential competitors. It is presently accessible upon request and will soon be available to users through the Global Trade Analysis Project (www.GTAP.org).

Product Market Analysis Portals is a recently developed tool that could contribute to identifying the major players at both home-country and company level. It is a partially subscription-based website (www.p-maps.org) that offers qualitative and quantitative insights into global markets for over 5,000 products traded by 180 countries and territories, providing relevant information for effective international market research. Of particular interest for identifying potential investors are the Business Contacts and Market Intelligence tools. Business Contacts provides links to trade-support institutions, online market places and trade directories and to companies active in a specific industry, including importers, exporters and wholesalers for a particular product in a defined country. Market Intelligence focuses on the qualitative aspects of market research and consists of full-text published market studies, as well as smart links to organizations involved in market research, product standards, packaging, sales promotion or trade fairs. Price News is also available for selected industries. In addition, a trade inquiry service is offered enabling subscribers to seek assistance from ITC on many aspects of international trade.

Source: ITC.

[a] Joint study by ITC and MIGA, in process. The covered countries include Ghana, Mali, Mozambique, Senegal, the United Republic of Tanzania and Uganda.

Box VIII.3. Trade analysis tools for investment targeting (concluded)



Source: ITC calculations based on COMTRADE statistics.

Note: the area of the circles correponds to the export value of the product group for Mozambique. See explanatory sheet for details.

fully exploited. Factors such as the size and growth of different industries, the number of firms in specific industries and the presence of strong supplier capabilities in an industry can be important assets for attracting some export-oriented firms. The same applies to the availability of natural resources (e.g. minerals, forests and energy) and human resources (e.g. skills at different levels of education, universities and R&D) which could be further developed by an inflow of FDI.[4]

However, strong historical export growth in a given activity and/or the presence of domestic capabilities in an industry do not mean that there is necessarily scope for export-oriented FDI. Further analysis is required of the extent to which a certain industry or activity is receptive to additional international investment. A first crude test is to identify foreign investors (as well as domestic companies) that are already exporting from the host country. This can be a good indication of further opportunities for export-oriented FDI, in the form of expansion or new investments. For example, foreign competitors of these affiliates and their suppliers and customers may all represent potential investors. Moreover, the presence of foreign exporters in, and export patterns of, similar locations (e.g. neighbouring countries and those with similar resource endowments) may also reveal opportunities for more export-oriented FDI.

Finally, as part of a preliminary assessment of a location's capabilities, attention should be given to trends and changes in the international business environment that might pose challenges or offer opportunities. This may relate to the trade policy regime of destination markets (section VII.A), the business cycle, technological developments (e.g. increased tradability of services; expanded use of information technology), the business environment in competing locations (tax changes, new trade policies or rising labour costs) and changing corporate strategies that favour the relocation of various activities. Consultations with export-oriented companies (foreign and domestic) can provide critical input into this process.

Obviously, such an assessment can be undertaken at various levels of sophistication and detail, depending on the availability of resources and the importance attached to the exercise. If resources are scarce, it may suffice, as a starting point, to adopt a relatively inexpensive rule-of-thumb approach, involving:

- An analysis of existing trade and industry patterns;
- Consultations with existing investors (domestic and foreign);
- An analysis of what competing locations are exporting and what they have attracted in terms of export-oriented FDI; and
- An identification of other factors that might attract export-oriented FDI, such as membership of free trade areas, preferential trade schemes, clusters of economic activity and industrial parks.

Even such a preliminary evaluation can provide useful inputs not only into the active promotion of a location as a base for export-oriented production, but also into the longer-term process of making a location more receptive to such FDI and benefiting from it (chapter VII). (For a concrete example of how an assessment of opportunities for export-oriented FDI was done for Albania, see box VIII.4).

Assessing the capabilities should not be just a technical exercise; it needs to be undertaken in a pragmatic way with different weights assigned to the various factors mentioned above depending on the specific circumstances. To become even more useful as an input both to investment promotion activities and as part of the monitoring of the business environment, the assessment should go one step further and evaluate in more detail the "competitiveness" of a location in specific areas (see annex to this chapter for more information).

b. Segmenting the market for export-oriented FDI

Once an assessment has been made, a process of segmenting the market for potential investment can be used to sharpen the focus of the targeted promotion. Investor targeting is not unlike the traditional segmentation activity commonplace in business marketing, in which potential markets are segmented using, for example, *economic, geographic, demographic* and *psychographic* criteria.

An *economic* segmentation can imply focusing on firms that operate in a particular industry or produce goods or services with a particular level of value added, and for which there is a good match with the location's

Box VIII.4. Assessing the potential for export-oriented FDI: the case of Albania

As part of its technical cooperation programme in the area of FDI promotion, UNCTAD prepared, in 2001, an Investor Targeting Strategy for Albania. The study looked at Albania's potential as an FDI destination and explored ways in which this potential could be further developed. It included an analysis of the potential for export-oriented FDI and offered concrete recommendations on ways of identifying and effectively promoting foreign investment in Albania.

The starting point was to classify Albania's largest export products into four groups, based on their trade dynamics. This approach assumes that additional FDI could be attracted into products or industries that are already internationally competitive (box table VIII.4.1). It is a useful first step towards identifying further export potential. In the product areas identified as "champions" and "underachievers", the Government of Albania was advised to implement measures aimed at expanding the national productive capacity of these products by attracting greenfield investment, as well as to continue to privatize relevant State-owned enterprises. For "achievers in adversity", the study advised targeting brand-name international manufacturers known for their niche-marketing skills. Mature products and mature markets required niche-marketing strategies aimed at differentiating products and marketing them to diverse consumer groups. Finally, the Government was advised not to target FDI in areas classified as "losers".

Taking into consideration the package of locational advantages offered by Albania, the Government was also advised to target investors in industries in which Albania could potentially develop international competitiveness. These included consumer electronics, electronic components and small non-electric machinery. The potential of these industries was based on the abundance of low-cost labour in Albania, large numbers of graduates with engineering degrees, the country's industrious work culture, and its short distance from major regional and European markets. In addition, Albania's potential future role as the Adriatic gateway to the Balkans may offer opportunities to TNCs searching for a low-cost site for regional manufacturing.

The assessment also yielded some important insights into some of the challenges facing Albania. Despite some success in attracting FDI during the 1990s, many export-oriented foreign investors interviewed for the study voiced concerns over deteriorating cost differentials between Albania and its neighbours. They pointed to two main areas in which Albania's cost advantages were diminishing: rising total labour costs (including wages, taxes and social charges) and high costs of imported capital goods, machinery and raw materials, owing to the prevailing structure of Albania's duty and value added taxes, and ineffective tax-reimbursement mechanisms. Finally, the investors noted that the cost of operating in Albania, in terms of the time and money required to deal with administrative obstacles and inefficiencies, had also risen. The Government was advised to address these issues, as they were adversely affecting the ability of Albania to attract export-oriented FDI, as well as to make further investments in the country's infrastructure and education system.

Source: UNCTAD and UNDP, 2001.

Box table VIII.4.1. Albania's export products, 1995-1999

	Products in which Albania is losing market shares in world trade	Products in which Albania is gaining market shares in world trade
Products for which export growth is above average	***Underachievers*** Beech wood lumber and related articles	***Champions*** Men's cotton pants and shorts Footware Cotton T-shirts Unprocessed tobacco Women's cotton shirts and blouses
Products for which export growth is below average	***Losers*** Ferrochrome containing more than 4 per cent carbon content	***Achievers in adversity*** Shoes upper parts Medicinal plants Select fruits and seeds Men's cotton shirts Women's synthetic dresses

Source: UNCTAD and UNDP, 2001.

specific assets. This form of segmentation is possibly the most frequently used approach to identify a set of firms. UNCTAD research shows that the export-oriented industries most commonly targeted by developed countries are high-technology manufacturing and business services (such as business and professional services, financial services, information technology, media, regional headquarters, call centres and shared-service centres) (UNCTAD, 2002d). Such industries are also increasingly targeted by a number of more advanced developing economies, including Hong Kong (China), Malaysia, Singapore (Low, 2001; Cheng, 2001) and, increasingly, China (*WIR01*, p. 26). Costa Rica's IPA concentrates its efforts on three main areas: electronics, medical devices and certain services.[5] In both Central and Eastern Europe and in developing countries, IPAs attach somewhat greater importance to basic manufacturing, for which competitive labour costs may represent a locational determinant. However, agro-based industries top the list in developing countries as well as in LDCs as a group (UNCTAD, 2002d).[6]

Another example of economic targeting is to identify export-oriented industries and firms that can benefit from a country's trade preference position (section VII.A). Several African countries are currently exploring ways to attract export-oriented FDI that could benefit from the improved access to the United States market through AGOA (see also section VII.A and chapter III). While there are divergent views on the potential offered by AGOA for many of the beneficiaries, this scheme does appear to have helped some countries to attract more export-oriented FDI. For example, since the launch of AGOA, Lesotho has attracted more than 10 new investment projects generating more than 10,000 new jobs (Masupha, 2002). The erosion of trade preferences over time, however, means that countries need to prepare themselves for the eventuality of no preferential access to key markets.

Some countries use existing clusters of industrial activity as the basis of their investor targeting. Such efforts tend to focus on attracting firms that can add to the dynamism and competitiveness of existing clusters. For example, the EDB of Singapore has made its investor targeting an integral part of a broader effort to promote the development of specific industrial clusters. It has chosen to emphasize existing clusters in the manufacturing sector and to attract FDI into new clusters in the services sector (Low, 2001). The Investment Promotion Centre of Israel focuses on the strongest industries in the economy; Invest in Sweden Agency begins with thorough research on how FDI can help strengthen the dynamism of existing clusters or competence blocks; and in Finland, investor targeting is determined partly by the focus of the national innovation system on the development of selected industries. The Malaysian Industrial Development Authority has identified 22 clusters, which are all seen as offering potential for attracting export-oriented FDI (Cheng, 2001).[7]

Competition makes it increasingly important for IPAs to identify not only which industry to target, but also the exact niche and activity within a particular industry that is likely to maximize the location's advantages. The more focused the approach, the easier it is to streamline IPA activities to meet the needs of investors and the smaller the risk that a country will focus on exactly the same investors as other countries. For example, within the automotive industry, a country may need to examine whether it should target the production of certain components (such as engines, tyres and electronic equipment) or assembly operations; in the area of call centres, it may aim at attracting low-skill operations (switchboard functions) or high-skill ones (e.g. technical support centres) for regional or global operations. The focus should reflect the strengths. The Thai Board of Investment, for example, has divided various segments of the agro-industry and the automotive, fashion, electronics and selected service industries (box VIII.5).

Another, often used, approach to market segmentation is geographic. IPAs frequently focus promotional resources on key home countries for TNCs. United States firms, for example, have been the most popular target for IPAs located in Ireland, the United Kingdom, South-East Asia and the Caribbean. Moreover, it is common among IPAs to target investors based in neighbouring countries.[8] In China, targeting has involved the development of industrial parks (e.g. in the province of Fujian) specifically tailored to attract TNCs from Taiwan Province of China, and (in the province of Guangdong) from Hong Kong (China) and South-East Asia. Some of the poorest countries may focus special attention on export-oriented TNCs active in the more advanced developing countries, in which rising labour costs are rendering low-technology activities

Box VIII.5. The targeted approach of Thailand

To make its efforts to promote FDI more effective, the Board of Investment (BOI) in Thailand is currently in a process of making its activities more proactive and targeted. One of the reasons behind this decision is greater competition from lower-cost locations. A more proactive approach is seen as an important way to improve both the quality and quantity of FDI, and to help enhance the sustainable growth of the Thai economy.

Five target industries have been identified based on their long-term growth potential, their need to be strengthened to be able to compete effectively in the global marketplace, or their need to be expanded and extended to take advantage of their competitiveness.

In *agro-industry*, Thailand has abundant natural resources, cost-effective labour, and proven production capabilities. Thailand is the world's largest exporter of rice, canned tuna, rubber and canned pineapples. These fundamental strengths are seen as a basis for the industries' transition into higher-value-added agro-processing by improving product quality, yields and sustainability.

The Thai *automotive* industry hosts almost every major auto assembler. They have been attracted by a combination of cost-effective skilled labour and the availability of parts and components suppliers, as well as access to the regional market. Assemblers such as Toyota and Fiat have shifted regional production into Thailand. Thai auto exports more than tripled over the past five years. An expected continued growth of exports opens opportunities for parts and components manufacturers.

The third industry is *fashion*, particularly leather, garments and jewellery. While Thai craftspersons are well respected for their artisanship, inward FDI is expected to help improve product design and to build up Thai products and brands.

Electronics, including information and communication technology, is regarded as key to Thai competitiveness and to the transition towards a knowledge-based economy. Thai electronic goods have long been widely accepted in global markets. The challenge is to move up the ladder from simple assembly to higher-value-added processing.

Finally, the BOI also targets *high-value-added services*, which includes software services, printing and long-stay tourism. For example, Thailand recently developed a tourism programme for long-stay tourists and designed it specifically with Japanese retirees in mind. It is expected that there will soon be special Japanese "long-stay villages" set up, complete with Japanese management.

For each targeted industry, policies, measures and marketing strategies specific to each industry will be developed, taking into consideration their needs, based on factors such as competitiveness, market potential and levels of technology.

The BOI has also adopted a geographical focus for its targeting. Three major regions and, within these, a number of home-countries of FDI have been identified: the regions of Europe (primarily the countries of the EU), Asia (especially Japan, China, Singapore, Taiwan Province of China and the Republic of Korea), and North America (United States and Canada). These regions will receive more investment missions from Thailand. Also, additional overseas offices will be opened in these regions to provide more individualized service to potential investors. During 2002, new offices will be opened in Shanghai and Hong Kong, China; in 2003, offices will be set up in San Francisco and Osaka. Local agreements with various organizations, such as other investment agencies, banks and provincial governments are expected to help the BOI better understand what investors are looking for.

These targeting efforts are complemented by measures to improve overall Thai competitiveness, especially with regard to small and medium-sized enterprises (SMEs). In this context, the BOI is transforming its regional offices in Thailand into marketing organizations to help improve the capabilities of domestic SMEs. Accordingly, the staff in these offices will be retrained to identify products that offer potential in international markets and will develop appropriate support packages, including incentives for these ventures. This is being done in close cooperation with other branches of government to ensure that promising SMEs receive the necessary support. The focus will be on the most promising enterprises. Foreign SMEs will be encouraged to provide assistance in such areas as technical assistance and market access.

Source: Wanapha, 2002.

uncompetitive. For example, this targeting strategy remains popular among a large number of African countries that have preferential market access to the United States and European markets, and also to the South African market. The Investment Promotion Centre in Kenya targets TNCs from South-East Asia for similar reasons. Export-oriented companies attracted to Kenya include Muthama Gemstones (Thailand) and Young Orientals (the Republic of Korea).[9]

Obviously, in most cases, investor-targeting strategies involve a combination of the economic and geographic market-segmentation mechanisms. The geographical focus may depend on the industry niche that has been chosen as a target and should reflect an analysis of where the principal sources of potential FDI in the targeted niche are.[10]

In the end, IPAs need to go beyond the identification of industries and countries and should select a set of individual companies and their management. This task can be more or less difficult, depending on what is targeted.[11] In industries and activities that are dominated by a few easily identified companies, finding the companies is relatively easy compared with industries in which the market structure is less concentrated. However, the more carefully a niche can be defined, the easier it is for an IPA to find the prime candidates for promotional activities. As suggested in chapter V, to arrive at the right selection of companies requires a good understanding of the industry dynamics. With the growing role of contract manufacturing and other forms of outsourcing, for example, IPAs need to decide whether they should target the final buyer of a product or the actual manufacturer, or both.

There is no standard solution to this problem. The strategy chosen has to reflect the structure that prevails in each type of activity and industry. Still, some rules of thumb can be useful in the process of selecting company targets. Important clues as to where to look for potential investors relate to foreign affiliates that are already established in the country. They are "living proof" of the existence of investment opportunities, and their presence may be indicative of where to search for additional investment. Their competitors, too, may potentially be prime targets, especially if the existing foreign affiliates are linked to leading TNCs. Companies that are part of the value chains of domestic as well as foreign affiliates in the host country (e.g. as buyers or suppliers) are also potential targets. Nurturing close contacts with existing firms may generate useful insights into their investment strategies and how these "related" firms make their investment decisions.

Moreover, an investor-targeting strategy has to recognize that companies and countries do not make investment decisions – individuals do. This means that IPAs ultimately need to identify not only companies but also key decision-makers within them at the levels of corporate headquarters, division or regional headquarters, or individual foreign affiliates. If IPAs do not reach the right people, there is a risk that much time and resources will be wasted, no matter how competitive a location is.

Demographic and *psychographic* criteria can sometimes be useful instruments to consider in this process. Some IPAs concentrate on firms with key decision-makers from the country's diaspora. This latter approach has been employed by countries as diverse as China, Croatia, India, Ireland and Israel, all of which have the common characteristic of significant diasporic communities (Wells, 1999). For example, China has attracted investments from TNCs controlled by overseas Chinese; Indian executives based in Silicon Valley have been encouraged to invest in the Indian information technology industry; and active policies by the Government of Israel helped to attract investments by members of the overseas Jewish community (Aharoni, 1966). The application of *psychographic* criteria involves taking lifestyle considerations of executive officers into account. For certain activities (such as head-office functions) undertaken by senior management, the taxation of individual incomes and the general quality of life can play a critical role.[12] IPAs in the United Kingdom and Switzerland have tried to attract such investment by leveraging their relatively low taxes on individual incomes.[13]

3. How to target?

There is no universally applicable method of targeting export-oriented investors. The best method depends on the kind of activity targeted and the specific features of each location. Nonetheless, there are a number of aspects related to the function and organization of IPAs that are relevant in this context.

IPAs use a wide array of promotional tools in their targeting efforts, ranging from advertising and telemarketing to personal contacts and site visits. The optimal mix of these various tools is determined by the kind of investment targeted as well as by the resources available. The main challenge is to provide relevant information through channels that will attract the attention of key decision-makers in the targeted firms and generate as many high-quality leads as possible. Effective targeting requires IPAs to be in a position to intervene, through a process of personal relationship-building – often over an extended period of time – at the level of key decision-makers, especially when a company gets nearer to making the final decision. Moreover, the more informed an IPA is about the plans and circumstances of a firm, the greater the chances that it will provide relevant information and make a competitive "offer".

One implication of this is that IPAs, both in their organizational and functional structure, need to be business-oriented and to develop strong links to the private sector. At the same time, they need support from the highest political level to perform their tasks. This orientation is far removed from the culture of investment authorities involved in screening FDI. Consequently, giving a former screening institution a new mandate to attract FDI can work only if there is a profound shift in organizational culture and orientation.[14]

IPAs have responsibilities and functions that differ from other government agencies and, accordingly, need a different organizational structure.[15] Depending on the specific context, a case can sometimes be made for including relevant expertise in the board of directors. Appointing board members with experience from the specific industries or activities that an IPA is targeting can be a way to ensure that an IPA is run in a business-like manner and to widen the network of the IPA in the relevant fields.[16] The choice of director of the IPA is another aspect to consider (Wells, 1999). To run an IPA effectively, this person needs the ability to interact both with the political leadership at various levels of the government hierarchy and with executives of domestic as well as foreign firms. Differences in salary levels in the private and public sectors can make it impossible to recruit professionals with long experience in the private sector. Still, a number of countries at varying stages of development, including Bangladesh, Denmark, Jamaica, Sweden, Uganda and the United Kingdom, have appointed former business executives to head their IPAs.

The need to build personal relationships with key decision-makers suggests that IPAs can also benefit from recruiting sales people who are comfortable with business operations and investment decisions. Indeed, professionals with hands-on experience in the target areas should be particularly useful to an IPA. A number of IPAs do emphasize this factor, including the Investment and Development Agency (IDA) in Ireland, the Welsh Development Agency and One North East in the United Kingdom, the Invest in Sweden Agency and Invest Hong Kong.[17] Hence this form of promotion is assisted by the implementation of compensation systems that reflect the nature of the experience and expertise required, allows for the recognition of high-quality performance (box VIII.6), and take account of the market compensation for such people.

During the investment decision process, many TNCs engage outside expertise to help evaluate different alternatives. Investment intermediaries, such as law firms, banks and accounting firms, may have a self-interest in generating (and alerting their clients to) investment opportunities. They can therefore be key channels of information for IPAs to foster. In addition, these intermediaries typically have well-established contacts with the right decision-makers that may be difficult for a government agency to develop. Organizations other than the national IPA may well be in a position to assist in the targeted attraction of investments. Examples are agencies in countries involved in extractive industries or tourism. The national IPAs may not consider promotional activities in these areas to be within their ambit of responsibility. When seeking to attract investments in areas of traditional strength, and when there are national agencies with specialized expertise in these areas, national IPAs can play the role of coordinator of the investment promotion activity. In a well-coordinated effort, a country's diplomatic service may also play a role, as is the case, for example, for Brazil and Egypt (box VIII.7).

Some countries have chosen to merge the responsibility for export promotion with that for FDI promotion, a rational choice if the aim is to expand export activities with the help of inward FDI. This may work well in some situations. Linking the two activities could potentially imply some cost-saving,

Box VIII.6. Costa Rica' s CINDE: the "other" story of promotional effectiveness

The success of Costa Rica's IPA, Costa Rican Investment Board (CINDE), in attracting Intel to its territory has become legendary in investment promotion circles. How did CINDE get to that point of promotional effectiveness?

CINDE was formed in the mid-1980s, with significant involvement of the Costa Rican private sector, and with substantial funding from the United States Agency for International Development (USAID). Early in its development, it adopted a targeted approach to its task, with advice from Ireland's Investment and Development Agency (IDA). Indeed, a seasoned IDA executive served as a resident adviser to CINDE for two years in the mid-1980s and introduced the principles of promotion that had worked well in Ireland.

The Agency's focus was largely geographic (United States) and industrial (electronics). It adopted a deliberate strategy to shift away from the previous dependence on natural resources and garments. Subsequently, business services, medical devices and special projects were added to electronics as targeted industries. A lean overseas promotional organization was developed with highly trained and well-compensated Costa Rican nationals engaging in a process of personal marketing to targeted companies. The Agency had a budget of approximately $2 million and just over 40 employees who were encouraged to build long-term relationships with the companies identified. Its compensation system allowed for bonuses for high-performing executives. Benchmarking against salary levels of the private sector and salary surveys were carried out with the help of consultants in order to establish a better fixed and variable income level. Much attention was also paid to the development of an Agency-wide investor tracking system to create an organizational memory for promotional activity, in addition to providing a basis for personnel evaluation and compensation.

CINDE was successful in attracting mainly small electronic firms to invest in Costa Rica during the late 1980s and early 1990s. It eventually hit a "hole in one" when it secured Intel's massive investment in the mid-1990s but this was preceded by many smaller achievements in the form of attracting small electronic firms that created the beginnings of an electronics cluster in Costa Rica. By 1996, companies such as Bourns-Trimpot Electronicas (electronic components), Espion (transformers and electronic switches), Cortek (coils), Suttle (telephone connectors), Altor Electronicas (transformers), DSC (circuit boards), Protek (electronic components) and Sawtek (frequency filters) had all invested in the country.

Costa Rica finally managed to attract the attention of Intel managers and to win the investment in fierce competition with more well-known locations, including Argentina, Brazil, China, Mexico, Singapore and Thailand. Among the main factors behind the success was the highest possible attention given to the electronics industry and to the Intel project by CINDE, involving even the President. Throughout the process, Intel was impressed by the way CINDE managed the project, under strict confidentiality. Moreover, thanks to substantial investment in, and a changed strategy for, its education system, Costa Rica had developed the necessary labour skills. Finally, a comprehensive incentive package, including income and municipal tax exemptions under the free zone legislation, helped to tip the balance in favour of Costa Rica. This was not the most critical factor to Intel, but it was important to other investors.

Other notable investments that followed Intel's include those by Abbott Laboratories (medical devices), Remec, EMC technology and Camtronics (electronic components), Sensortronics (sensors) and Aetec (board contractors). More recently, Costa Rica's targeting efforts have paid off in the services sector as well. Successes in 2001 include the decision by Procter & Gamble to site its shared-services centre for the Americas in Costa Rica and Western Union's decision to establish a financial services centre.

Today, CINDE is a state-of-the-art IPA. On the basis of studies as well as positive experiences of foreign affiliates in Costa Rica, CINDE identifies the areas in which Costa Rica enjoys a comparative advantage at a given moment. The identification of target areas is dynamic and subject to change. CINDE does not promote mass-market products but rather niche areas with small production runs and medium-to-large requirements for a skilled workforce. With the exception of Intel and Abbott, medium-size investments in high-technology manufacturing, high-value products and skill-intensive services are the targets. The common link among them is Costa Rica's human resources, which are the basis of the country's strategy for development. The country's comparative advantages are regularly reviewed through benchmarking with selected competitors for specific investment projects and the targeting efforts adjusted accordingly. There are important expectations with the recent creation of the CAATEC Foundation, a joint effort of individuals

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Box VIII.6. Costa Rica' s CINDE: the "other" story of promotional effectiveness (concluded)

from the private and academic sectors who work together to enhance the country's competitiveness for high-technology investments. As part of Costa Rica's "e-readiness" programme, CAATEC seeks to provide online financial services to SMEs and to help enhance their ability to participate in the knowledge-based economy (Egloff, 2001b).

In a sense, the success of the Costa Rican Investment Board in attracting the Intel project converted its FDI policy into a concrete manifestation of the new development policy (Rodriguez-Clare, 2001). Nevertheless, Costa Rica remains weak in embedding export-oriented FDI in the local economy. There is as yet little evidence of linkages, clustering effects or the upgrading of domestic supplier capacities, despite the implementation of programmes such as Costa Rica Provee and Impulso, which have been set up with this kind of objective in mind. In order to sustain its success, Costa Rica will have to diversify its exports to other markets and improve the links between export-oriented production and domestic enterprises.

Source: UNCTAD, based on information provided by CINDE; Egloff, 2001b; Spar, 1998; Rodriguez-Clare, 2001, www.caatec.org, June 2002.

Box VIII.7. Training diplomats in FDI promotion

Egyptian diplomats have benefited from UNCTAD's training in investment promotion and investor targeting through the organization of a series of training workshops. They are designed for mid-level and senior-level diplomats and aim at providing basic, practical knowledge about investment promotion and investor targeting. Typically, a three-day workshop includes the presentation of global and regional FDI trends, an overview of corporate decision-making processes, and a discussion of company cultures and ethics (highlighting the differences in company perceptions and management styles). It also covers a number of quantitative techniques used in investment promotion, such as the strengths, weaknesses, opportunities and threats (SWOT) analysis. The training material is supported by concrete examples and case studies, and can include the latest trends in Internet-based investment promotion.

Source: UNCTAD.

particularly in the cost of overseas offices, and may be an attractive option for agencies involved in cluster development, for which FDI and export promotion can be closely interlinked. On the other hand, there may be good reasons to keep investment and export promotion apart. First, the skills required for the two activities typically differ. Decisions related to the purchase of a service or product and those related to investment tend to be handled by different parts of a company. Reaching and convincing top management to invest in a certain location is a very different task from that of helping domestic firms to expand their sales overseas. There is also the risk of responsibilities becoming fragmented and the agency's work becoming less focused, with the possibility of neither function being performed well. Thus, whether the two activities should be merged or kept separate depends on whether government efforts in the two areas can be made to complement and reinforce each other.

As the preceding discussion indicates, there are many issues to be considered when embarking on targeting. IPAs intending to do so can benefit from an exchange of experiences with "market" leaders in this area, as well as from specific training courses (box VIII.8). A concrete example of how a southern European IPA shifted from a reactive to a proactive approach to investment promotion is given in box VIII.9. The point to emphasize is that successful targeting in a highly competitive world market for FDI requires a long-term, professional approach.

Box VIII.8. Training courses in investor targeting

An example is UNCTAD's newly developed training product entitled *Third Generation Investment Promotion: Investor Targeting*. It aims at fostering an understanding of the latest concepts and trends relating to FDI, sharing best practices in generating investment and, in particular, providing key tools and skills to develop a targeted approach to investment promotion. Key issues addressed include:

- *What* factors influence the decision to invest?
- *How* do TNCs shortlist locations?
- *What* determines which industries and companies to target?
- *What* do firms consider effective corporate development support?
- *Why* is investor targeting an efficient way to promote FDI in a location?

The product consists of a tailor-made workshop (3-8 days) and a master reference manual.

Source: UNCTAD.

Box VIII.9. Moving from a non-focused to a targeted approach: the case of a southern European IPA

At the end of the 1990s, an IPA from a southern European country had a reactive approach to investment promotion. It basically responded to any investment enquiries that came in from interested investors. The agency – which combined trade, tourism and inward investment functions – also suffered from organizational weaknesses. There were few project officers dedicated specifically to attracting investment, and the agency was not mandated to act as a one-stop shop.

Prompted by a sharp decline in inward FDI in 1999, the IPA decided to implement a major change in investment promotion policy and organization. It managed to get better control over incentives and took steps to improve its internal efficiency. For example, a cohesive team was put together, also involving project officers abroad; commercial practices were introduced, in particular, in sales (promotion); quarterly sales plans were developed and agreed; twice-yearly sales meetings were introduced to discuss opportunities, share best practices and new research, and ensure a coordinated approach; and a dynamic leadership was put in place to supervise the changes. The IPA also decided to shift from a reactive to a proactive investment strategy. Targeting was at the heart of this strategy. There were several key stages to developing and implementing the proactive, targeting strategy:

Identification of target industries and markets. Four target industries were identified according to the competitive position of the location, opportunities in the FDI market, and the strategic industry objectives of the national Government. The target industries consisted of activities for which the location had achieved considerable success in attracting FDI (electronics, automotive), and which had opportunities for upgrading and attracting higher value-added activities. Also, the agency hoped to cash in on the growth of newly emerging services (front and back offices and telecommunications) where other countries had been successful. For each target activity, key sub-activities were identified, based on the specific competencies of the location: for example, in electronics, R&D related to consumer electronics, R&D and manufacturing related to automotive electronics and R&D related to semiconductors were prioritized. For each industry, target overseas source markets were identified.

Development of an FDI database. An investment database was developed with the assistance of external consultants to provide comprehensive, comparative data on the possible information requirements of potential investors. For each target industry, more detailed information was provided, together with key selling messages for promoting the location. The database is used for developing marketing materials and business propositions and handling investment enquiries. It is also used as a knowledge tool to update data on the country and on competing locations continuously. Project officers were trained in the use of the database.

Company targeting. A three-dimensional targeting policy was developed, focusing on new potential investors, existing investors (aftercare), and intermediaries who influence location decisions. For each target source market, potential investors were identified in the target industries based on existing market intelligence, business databases and other industry sources.

Roll-out in overseas offices. A project officer in each overseas office was given responsibility for implementing the targeting policy. Project officers developed initial contacts with potential investors and intermediaries in the source country. The objective was to develop a long-term approach to targeting companies. Techniques used included drip-feeding companies with the latest information (quarterly reviews), building contacts with the diaspora community and organizing networking events, such as wine tasting, in the embassies. Meetings set up with companies were attended by senior officials from the IPA.

Coordination and results. There was active monitoring and evaluation of results. The initial company targets were re-evaluated and companies with weak investment prospects were removed to allow focus on the best opportunities. It took over one year for the targeting to yield significant results. Since 2000, 75 per cent of FDI projects in the country have been in the target industries. Major electronics and automotive investments have been secured through the aftercare programme and the location has been put firmly on the map for new service functions. However, the longer-term success of the country will depend on implementing much-needed product development initiatives to attract more knowledge-based investment.

Source: UNCTAD, based on information provided by PricewaterhouseCoopers Consulting-PLI, Belgium

4. What are the pitfalls and risks?

Adopting an investor targeting strategy can be effective in attracting FDI, but it also presents considerable challenges for Governments. To be effective, investor targeting has to be well integrated into the overall development strategy of a country. Attracting export-oriented FDI is not an end in itself; rather, it is a means to speed up development. In this sense, the role of IPAs goes beyond a purely promotional mission. IPAs need to work closely with other parts of the Government to identify and, indeed, create comparative advantages that are sustainable rather than ephemeral.

Targeting therefore should not be a one-off initiative but a continuous learning process. IPAs need to recognize the importance of dynamism in niche market identification and be aware of the need to revise their strategies over time, as competitive conditions and corporate strategies evolve. National advantages based upon preferential market access, for example, are valuable, but must fit into a clear plan for creating sustained advantage over time. IPAs can contribute to such plans, but their conceptualization and implementation involves other agencies of government and public-private partnerships. In certain situations, IPAs can play a catalytic role in setting up such constellations aimed at improving the competitiveness of a location (box VIII.10). Their ability to do so is enhanced when there is congruence among key national institutions about the approach to development and the role of FDI in the development process.

Of course, the notion of development strategies brings to the fore the industrial policy debate on the appropriate role of government. While this is not the place to review the extensive literature on this subject, it should be noted that an investor targeting strategy, with its emphasis on focusing resources – promotional, fiscal and infrastructural – on a defined subset of all potential foreign investors is an example of selective intervention. And, of course, there are risks attached. Resources may be focused on seeking investments that do not materialize, or considerable efforts and resources may be devoted to attracting the wrong types of firms, or firms that would have invested in any event. There is also the risk of assuming the government's ability to foresee which types of FDI are likely to have the greatest ability to integrate and link with indigenous investment.

These risks are real and efforts need to be made to mitigate them. Such risk-reducing measures include, first of all, an appropriate sequencing of promotional activity. Thus, improving the overall policy environment for investment – domestic and foreign alike – should not be sacrificed to a selective focus on attracting a few firms. Also, targeting should respond to market signals as far as possible, for example, by focusing on firms that have already demonstrated an interest in operating in the country through the establishment of affiliates.

Other risk-mitigating measures involve incrementalism and realism in targeting. It should be based on a proper understanding of the strengths and weaknesses of a location as a base for export-oriented production, and it should not be expected to pay off instantly. There is an obvious risk of wishful thinking in seeking to win "high-status" TNCs (à la Intel) if a country does not have the basic conditions to attract this type of investor (such as an educated and highly skilled workforce and excellent, low-cost infrastructure). Winning this sort of flagship investment requires a long-term, concerted and coordinated effort among all government departments at the highest level, an effort that is difficult and expensive to muster, although the rewards are high, since countries that do manage to attract leading TNCs in oligopolistic industries often benefit from additional investment by their competitors and suppliers. It needs to be borne in mind that competition for high-profile investment projects can be intense and, for every winner, there are often several losers that, in the end, will have expended considerable resources in a failed attempt to attract a project. Thus, for most developing countries, the investors to target will *not* be the top 100 TNCs (chapter IV), but rather, smaller firms within the appropriate industry or activity. As mentioned above, Costa Rica's targeting did not begin with Intel; it was the result of a long process of building the capacity to attract firms like Intel.

Clear criteria of accountability and performance evaluation should help mitigate the risk of IPAs expending considerable resources without producing substantial results.

Box VIII.10. Building an FDI-based cluster: the case of Socware in Sweden

Invest in Sweden Agency (ISA) bases its marketing efforts on industrial clusters that offer a dynamic environment to potential investors. If ISA finds that there is potential for FDI in an area of Swedish strength, it invites partners in academia, the private sector and relevant public agencies to participate in its effort to build or develop a cluster. Together, the partners finance one or more feasibility studies to define the potential Swedish offer more carefully. This research forms the basis for a proposal to the Government. Before any actual promotion takes place, a long-term political commitment is also secured by the ISA.

The "Socware" project is a good example of this, even though external factors have thus far kept its results relatively modest. In 1998, ISA noted a growing interest among leading semiconductor makers in concentrating their activities in systems design. Such knowledge-intensive centres were expected to emerge in only a limited number of places around the world, and ISA sought to find out whether Sweden could become one of them. To this end, it organized discussions with leading representatives of academia, foreign and Swedish companies, and government agencies from the local, regional and national levels. In addition, feasibility studies were commissioned on technological requirements and market opportunities.

Following intense discussions with the parties involved, over an extended period, it was decided to go ahead with plans to form a cluster around the designing of systems-on-chips. ISA coordinated the process and was also responsible for the international promotion of the cluster. Moreover, three Swedish universities agreed to set up a new Master's course in Socware design and to expand their PhD programmes to increase the availability of the skills needed. Special efforts were also initiated to ensure that the legal framework was adequate for the protection of intellectual property rights. In 2000, a new institute for industrial research (Acreo) was established to strengthen the link between academia and industry.

The annual marketing budget of the Socware project is approximately $0.4 million. The agency recruited staff with proven experience in the relevant area. ISA has especially sought to employ professionals with a strong network of business contacts and an ability to interact with top executives in the relevant business segments.

The actual targeting of firms is based on careful market research of the leading players in the field. ISA first turned its attention to Taiwan Province of China. The rationale for this decision was that Taiwanese companies offered world-class competence in semiconductor manufacturing but were not equally strong in the area of systems design, an area in which Sweden has a strong track record. The Swedish offer was made even more competitive because of the presence of leading-edge capabilities in telecommunications and, especially, wireless technology, two areas for which systems-on-chip design is of critical importance. After an in-depth analysis of the corporate sector in Taiwan Province of China, ISA has so far visited 15 Taiwanese companies. It has also visited six companies in Japan, four in the United States and four in the Republic of Korea.

The dramatic recent slowdown in the semiconductor industry has meant that the results have not so far met expectations. Still, since active marketing began in mid-2000, Sweden has attracted three significant investments related to the project: Atmel and National Semiconductor (United States) and Via Technologies (Taiwan Province of China). ISA is currently in the process of intense discussions with eight other companies seriously considering setting up design activities in Sweden. Other important positive results of the Socware project are an increased flow of professionals to Sweden and a rise in the number of engineers graduating with the appropriate background. Financing for the Socware project has been secured for five years to start with, after which period the project will be evaluated.

Source: UNCTAD, based on information provided by Invest in Sweden Agency.

An important tool in this regard is the establishment of realistic targets against which performance can be measured.[18] IPAs should have monitoring mechanisms in place that allow for accurate reporting on expenditure and results. In practice, very few IPAs are systematically evaluated and monitored (UNCTAD, 2002d; Wells, 1999). In an UNCTAD survey of more than 100 IPAs, only one-third of the agencies used quantitative measures (and an even smaller percentage used qualitative ones) to evaluate their performance (UNCTAD, 2002d).

Finally, a targeted approach does not eliminate the need for a certain amount of "general promotion". An IPA needs to be prepared to respond to enquiries that fall outside the activities and industries explicitly targeted. Indeed, such spontaneous and unexpected enquiries can often be just as important as those generated through proactive

promotion. The problem IPAs face is that it is not possible to target everything without, by definition, ending up by targeting nothing. Hence, there is a need for IPAs to strike a balance between resources spent on proactive targeting and those spent to respond effectively to unexpected enquiries. Equally important is ensuring that potential investments are not lost through inefficiencies in the handling of projects.

B. Investment facilitation

While the trend towards creating a more enabling framework for FDI continues (chapter I), many countries still evaluate and screen FDI at the point of entry. While such regulations serve different purposes, the time required to obtain the various licences, permits, and approvals needed can sometimes be considerable and can negatively influence the cost-efficiency of a location. The costs in terms of both money and time are especially important to export-oriented foreign investors, as they cannot pass on these costs to their buyers. (They must sell at prevailing world prices.)

One study of the procedures governing entry regulation in 85 countries and the costs of following these procedures found huge variation across countries (Djankov et al., 2001). The total number of procedures ranged from 2 in Canada to 21 in the Dominican Republic, and averaged 10.5 for the whole sample. In terms of the minimum number of business days required to start a new business, there was a range from 2 days in some developed countries to 152 days in Madagascar. Ironically, low-income countries with a lower level of institutional capacity generally impose more regulations on the private sector than do high-income countries with greater institutional capacity. Moreover, a strong correlation was noted between the level of corruption and the number of registration procedures that an investor had to go through.

There are usually a number of government institutions involved in the entry and establishment process. A TNC may need to deal with tax authorities, immigration boards, investment boards, customs authorities and others. In many developing countries, IPAs have been set up partly to facilitate investment entry. However, even when IPAs are granted one-stop shop status, the involvement of some other institutions is often still necessary. The efficiency of all these government bodies influences the time and cost associated with making an investment.

One way for IPAs to attack regulatory inefficiencies and red tape is to develop so-called “investor road maps”. This methodology has been developed by the Foreign Investment Advisory Service (FIAS) and is a tool for identifying and reducing the number and scope of procedural steps, regulatory requirements and administrative barriers that constitute the day-to-day interactions between the Government and entrepreneurs. Conceptually, the methodology is based on the assumption that creating an enabling environment for private-sector activity requires improvement in the implementation of policy.[19] It can be used for three purposes:

- To inform investors of the regulatory hurdles and costs of investment and operations that they face;
- To demonstrate the totality of the regulations and the costs they impose on private investors; and
- To help Governments reduce the regulatory burden on the private sector.

IPAs can also reduce administrative barriers by fostering the development of industrial and export processing zones (section VII.F). In addition to good infrastructure and tax incentives, such zones can constitute islands of administrative efficiency and provide a buffer between export-oriented foreign investors and the regulatory authorities.

Beyond ensuring that application-processing times are reasonable, given the requirements of investors, IPAs can also help ensure that the relevant laws and regulations governing export-oriented FDI are easily accessible by foreign investors and their representatives. Increased transparency of the administrative system and investment procedures makes it easier for TNCs to predict costs for the realization of investment projects. A range of instruments have been applied to improve public governance in different parts of the world, including performance assessments, e-government and codes of conduct. To assist LDCs in developing good governance in investment promotion, UNCTAD launched a project in 2002 focusing on

encouraging good governance in LDCs in the area of investment promotion (box VIII.11).

The extent to which IPAs provide the service necessary to facilitate a smooth handling of incoming investment projects can be assessed. Such an evaluation can be done in-house or with the help of external expertise. In general, it is useful for IPAs to be able to offer a single point of reference to foreign investors with regard to obtaining permits and licences to operate in a country. This is all the more important in countries that do not boast an efficient bureaucracy and have a high level of corruption.

Box VIII.11. Good governance in investment promotion

In 2001, at the LDC-III Conference in Brussels, UNCTAD launched a new initiative to assist LDCs in their efforts to promote good governance in investment promotion and facilitation. The first phase of this programme started in 2002 and is focused on five countries: Ethiopia, Lesotho, Maldives, Mali and the United Republic of Tanzania.

For the purposes of UNCTAD's programme, good governance in investment promotion and facilitation is measured by the efficiency and transparency of investment-related procedures and practices. The first phase of the programme involves advisory work and training carried out in close consultation with other national initiatives to promote good governance. This is followed in each country by a national seminar at which results and recommendations are presented to an audience of stakeholders, and agreement is reached on a plan of action.

Training is provided to officials involved in investment promotion as well as to those that deal with post-investment activities such as the issuing of permits, customs clearance and site selection. The project also includes the training of trainers in order to establish sustainable local training capacities.

The first phase will be concluded with an international conference, at which the lessons learned and international best practices will be shared with Governments from project and non-project countries, the private sector, development partners and non-governmental organizations (NGOs).

Source: UNCTAD.

Greater use of *e-government* by IPAs and other relevant authorities can increase efficiency and transparency in government services and reduce costs in the medium and long run. It involves the use of information technologies (especially the Internet) to enhance access to, and delivery of, government services to citizens, businesses and public-sector employees (UNCTAD, 2001e). For example, IPAs may include on their website a listing of all the required permits and licences for investment projects, how and where to obtain them, applicable fees, maximum processing time and whom to contact in case of problems.

The introduction of *codes of conduct* for civil servants can support efforts to introduce ethical standards on a formal basis in the public sector. There are a number of countries that have such codes. Members of the OECD, for instance, have agreed to maintain a reference checklist of 12 principles to support Governments in their review of ethics-management systems. The introduction of a code of ethics is a part of that checklist (OECD, 2000c).

Tasks of IPAs related to that of investment facilitation concern the provision of services to existing investors and encouraging other branches of government to improve the investment environment. These two policy areas are addressed next.

C. Aftercare services

With the expansion of international production systems and the number of export-oriented foreign affiliates, the role of aftercare services assumes increased importance. Governments can introduce policies that encourage foreign affiliates to export more and higher-value-added products and services.

Foreign affiliates that are part of an international production system face not only external, but also internal competition. When making new investment and expansion plans concerning export platforms, TNCs consider the possibility of developing an existing plant before buying or establishing a new one. When there are multiple plants within a TNC's production network, the management of a foreign affiliate may have to convince headquarters that its site offers the best conditions for an expansion. IPAs and other

host-country actors can sometimes become allies of the affiliate in such cases and strengthen its bargaining position vis-à-vis the head office (box VII.12).[20] The experience of Ireland, Singapore and Wales shows that building a constructive relationship with existing foreign investors can be an important and cost-effective way to promote the expansion and upgrading of exports.

While IPAs generally recognize the importance of reinvestment and aftercare services,[21] few have adopted a systematic approach to that end and fewer still have programmes linked specifically to the export dimension. Among those that have developed structured programmes of aftercare services and relationship-building with existing firms, a "sales account" orientation is typically used to ensure that their locations will be well-placed for consideration in the next round of investment decisions (Phelps and Fuller, 2001; Kwon, 2001). One approach is to use an *investor tracking system*. A number of IPAs, often with technical assistance, have developed computerized versions of such systems. They track investors from first contact, through the application and approval stages, to facility construction, and ongoing operations. With limited resources, an investor tracking system could initially focus on affiliates that are already exporting. Each affiliate is assigned to a "case officer" who follows them through these processes over time and periodically visits them to maintain contact. Once an investment is in place, the investor can be handed over from the initial case officer in the investment generation department to another officer in the monitoring department. An investor tracking system can be used to generate reports of the status of each investor through each stage of the investment process. During the operating phase, it can provide "trigger points" at which IPA personnel contact investors to assess their status, problems, plans for further investment, and ways in which the IPA can assist them in their operations. Such relationship-building can be an important step in identifying specific areas in which improvements are needed to facilitate more and higher-value-added exports from the affiliate in question.

Box VIII.12. Helping an affiliate to expand exports: the case of Black & Decker in the United Kingdom

In 1998, the corporate headquarters of the United States firm Black & Decker announced that it was planning to close a plant in north-east England. The regional IPA, the Northern Development Company, which had built up a constructive relationship with the local management of the Black & Decker affiliate, helped it to prepare a business plan that could be submitted to headquarters, outlining how the company could cut costs through a more efficient use of the supply chain. The plan also envisaged the creation of a supplier village at the plant (with the support of local authorities) to attract quality international firms.

Instead of closing the plant, the head office closed another European plant, shifted production to north-east England and set up a design and R&D centre there to develop products specifically for the European market. The 1998 expansion involved new investment of £17 million, which created 350 new jobs and safeguarded 775 jobs. About 75 per cent of the output produced at Black and Decker's affiliate is exported. Its product development and manufacturing operations based in Spennymoor, County Durham, are the largest in the Black and Decker network.

Source: Loewendahl, 2001b, p. 317.

In Wales, the Welsh Development Agency set up an accounts system after a suggestion from one major foreign affiliate that had been frustrated with multiple points of contact in its attempts to secure additional export-oriented investment from its parent company (Phelps and Fuller, 2001). The experience of Ireland is also illustrative. The Investment and Development Agency focuses on consolidating and building on the value of the 1,200 companies already in Ireland and supported by the Agency. It seeks to ensure that these companies continue to increase their value and contribute more, both to their own corporate success and to the Irish economy. Many of these companies are achieving this particularly by adding high-value research activities to their Irish operations. The Agency actively encourages firms to move up the value chain. While manufacturing activities will continue to remain a fundamental part of Ireland's development programme, over time, the investment being sought will be based more and more on innovation and research involving knowledge-intensive projects that require high skills and expertise.

Aftercare activities should be closely coordinated with various "product development" efforts. In order for existing foreign affiliates to be able to upgrade their activities, it is normally necessary for the location itself to become more hospitable to such an upgrading of production. Building close relationships with existing investors helps an IPA to provide useful inputs to other branches of government on how to enhance the attractiveness of their host country to export-oriented investors. An IPA can sometimes act on its own to improve investment conditions for export-oriented foreign and domestic investors, even if they remain unchanged in the economy as a whole. For example, if a low level of infrastructure development is a deterrent to export-oriented investment, the IPA can advocate placing infrastructure projects on the "promoted industries" list so that investors in this sector receive investment incentives. Investment in infrastructure is often impeded by laws and regulations that restrict FDI in terms of land ownership or in areas such as telecommunications or electricity generation or transmission. The IPA can advocate relaxing these restrictions. However, since many of the locational determinants are outside the area of responsibility of most IPAs (for example, political instability), these agencies need to have constructive relationships with the topmost levels of the government and bureaucracy, especially with departments whose policies and operations have an impact on investment flows.

One role of aftercare services is to help investors when they encounter problems that may hinder or postpone a continuation or expansion of an export-oriented project. A new approach in this context involves the appointment of an investment ombudsperson (Sauvant, 2002). This approach has been used, for example, in the Republic of Korea. In 1999, the Korean Trade-Investment Promotion Agency established an "Office of the Investment Ombudsman" (box VII.13). Some of the complaints and grievances handled so far have been directly related to export activities. When the Office is informed about a complaint, it is expected to act immediately and contact the relevant institution with a view to remedying the situation. It is empowered to request cooperation from concerned government authorities, which in turn have to address the issue without delay and present a plan for its resolution within seven days of receiving the request. Within the Ombudsman's Office an "Investment Home Doctor" programme has been established. Each registered foreign affiliate is assigned a "Home Doctor" to whom it can address any grievances. For example,

Box VIII.13. Office of the Investment Ombudsman, Republic of Korea

The Office of the Investment Ombudsman was established under Article 15 of the Foreign Direct Investment Promotion Act of 1998 as a means to resolving difficulties experienced by investors in the Republic of Korea and enhancing the overall business climate.

The Ombudsman is appointed personally by the President of the country and is a member of the Foreign Investment Committee, which is composed of 12 ministers and 16 high-ranking provincial and metropolitan officials. The Office has a staff of more than 20 professionals with expertise in areas such as legal, financial, trade and labour affairs. From its inception in October 1999 to the end of 2001, the Office had received a total of 1,084 grievance cases from foreign affiliates in the Republic of Korea, covering a variety of issues such as customs, construction, financial affairs, labour, taxation and investment procedures. Government agencies are required to respond to a request from the Ombudsman's office within seven days.

A few examples illustrate the work of the Office. To protect the trademark rights of exported and imported goods, the Office suggested in 2001 that the Customs Office implement a computerized system to cover relevant trademarks and introduce various scientific measures. As a result, the Customs Office signed a contract with a subcontractor for developing a trademark-rights management system and embarked on implementing a pilot operating system. Another example concerned the issue of land usage. One foreign affiliate had deferred its plans for further investment because it felt that the requirements for being designated an EPZ were too stringent. After reviewing the case, the Ombudsman's office proposed that the amount of investment and the number of employees required to qualify as an EPZ be reduced. Other examples include reform of the operations of bonded factories for raw materials and exemptions from specific administrative requirements related to imports to facilitate the expansion of exports.

Source: UNCTAD, based on the Office of the Investment Ombudsman, 2001; Kwon, 2001 and www.i-ombudsman.or.kr/history/mission_fs.html.

in response to a complaint from a company that exported 95 per cent of its products, the Office initiated a process that led to the abolition of a distinction between domestic and exporting bonded factories (Office of the Investment Ombudsman, 2001). This effectively enhanced the competitiveness of bonded factories in the Republic of Korea and is expected to have a positive impact on the country's exports.

* * * * *

In sum, the role of IPAs is evolving. In countries in which FDI is seen as an important policy area, IPAs can play an instrumental role not only in attracting export-oriented FDI, but also in encouraging foreign affiliates to move into higher-value-added exports. Throughout, the success of an IPA in helping a country meet its specific development objectives rests largely on how well its activities are integrated into broader economic and industrial policies. Given the overriding objective of matching the firm-specific capabilities of TNCs with the development objectives of host countries, IPAs need to interact efficiently with both the private and the public sector. Targeted promotion is not easy but it is an approach that has generated significant results in a number of countries. If properly implemented, targeting can make the entire process of attracting and benefiting from export-oriented FDI more effective.

Notes

1 See, for example, Watzke and Mindak, 1987; Wells and Wint, 1990; Young and Hood, 1994; Loewendahl, 2001a; UNCTAD, 2002d.

2 In principle, the approach outlined below can be applied at sub-national levels too, with the main constraint being the limited availability of data on some aspects.

3 Another useful tool is the software developed by the Economic Commission for Latin America and the Caribbean, called CANalysis, which provides world market shares in global and regional markets by product and by technology classification. These are the data used in the analysis of export winners in the preceding chapter.

4 The most convenient source of data on educational enrolments and R&D spending is the *Annual Statistical Yearbook* published by the United Nations Educational Scientific and Cultural Organisation (UNESCO), large parts of which are now on the Internet (www.unesco.org). The *Human Development Report* of the United Nations Development Programme (UNDP) has data on education and other aspects of well-being (www.undp.org). UNIDO provides composite measures of skills, technological effort and technology imports for 87 countries in its *Industrial Development Report 2002* (www.unido.org). The OECD also publishes innovation and R&D data for its member countries, generally available on the Internet (www.oecd.org).

5 UNCTAD's survey on investor targeting, February, 2002.

6 For example, the Commission for the Promotion of Peru has identified tourism, fisheries, agro-industry, mining and infrastructure as its target industries. Uganda's focus on attracting foreign investment into its fish industry is another case in point.

7 The internationally linked clusters encompass electrical and electronics; petrochemicals; pharmaceuticals; textiles and apparel. The policy-driven clusters are automotive; marine; motorcycles; aerospace; polymers; metals; composites; ceramics; machinery and equipment. Finally, the resource-based clusters include wood-based products; rubber-based products; palm-oil-based products (food and non-food); cocoa-based products; fish and fish products; livestock and livestock products; fruits and vegetables; and floriculture.

8 UNCTAD's survey on investor targeting, February, 2002.

9 Communication from the Investment Promotion Centre in Kenya.

10 For example, Puerto Rico's Industrial Development Company decided to target the pharmaceutical industry (economic criterion) partly because the country already hosted a number of foreign affiliates in the industry. There was also a geographic element involved: beyond targeting firms from the United States, which has historically been the main source of FDI and represents the primary export market, other potential countries with large pharmaceutical exports to the United States were identified (by analysing United States import data) for targeting, and companies were identified within those countries.

11 Some IPAs focus only on firms of a particular size. In China, for example, some provinces specifically target the Fortune 500 companies. In the early 1990s, China started targeting the largest TNCs in the world. The ability to attract such TNCs has become an important performance indicator for many sub-national IPAs. So far, China has succeeded in attracting about 400 of the Fortune 500 companies to invest, a large number of which have multi-projects under a holding company in Beijing or Shanghai that reports directly to the headquarters in the home country (*WIR01*, box I.3).

12 When executives of Swedish TNCs were asked about the most important factors determining

the location of head-office functions, taxation of individuals was reported to be the second most important criterion after access to efficient air transportation (Braunerhjelm and Lindqvist, 1999; ISA Economic Council, 1999).

13 The rate of individual taxation is emphasized by London First Centre and Location Switzerland.

14 Given the difficulties in transforming screening institutions into IPAs, some countries like Mexico and Venezuela have chosen to start afresh and create completely new organizations for investment promotion (Wells, 1999).

15 At the same time, IPAs need to be able to interact efficiently with other parts of the bureaucracy, not least to facilitate the investment process (section VIII.B).

16 Copenhagen Capacity, a Danish sub-national IPA, is a good illustration of this point. This IPA targets regional headquarters (for which air transport is key), R&D laboratories (for which skilled labour may be the main attraction) and TNCs in industries represented by board members. Consequently, its board includes representatives of the local government, the CEO of Copenhagen Airport, the President of the Copenhagen Business School, and a number of CEOs of Danish and foreign companies.

17 *WIR01* and UNCTAD's survey on investor targeting, February, 2002.

18 Targets may be related to inputs (number of enquiries, visits, etc.), outputs (number of projects, jobs and value of investment), quality of investments (type of investment, mode of entry, R&D intensity) and agency impact (level of investor support and customer satisfaction).

19 Procedures at the municipal, provincial and national levels can be related to: *employment* (e.g. visas, residency permits and work permits for foreign investors and expatriates workers, and procedures for hiring local employees); *locating* (e.g. site acquisition and development procedures, utility hook-ups, and environmental compliance); *reporting to the Government* (e.g. business registration, tax registration, special licenses and permits, and privatization procedures); and *operating in the host country* (e.g. product certification, regulatory inspections, tax payment, and import/export controls).

20 There is a growing literature on how the mandate and functions of foreign affiliates can be affected through bargaining between corporate headquarters and the local management of the affiliates (see Birkinshaw, 2001, for a review).

21 Young and Hood (1995, p. 293) define "after care" as that "which comprises all potential services offered at the company level by government and its agencies to facilitate both the successful start-up and the continuing development of a multinational affiliate in a host country or region, with a view to maximising the local economic development contribution of that affiliate".

CONCLUDING OBSERVATIONS:

Benefiting more from export expansion

Building export competitiveness is a high priority for both developed and developing countries – for good reason. As Part Two argued, countries that manage to link up to international markets through trade in goods and services can reap gains in employment, income and efficiency. International production systems and increased specialization in many industries provide new opportunities for developing countries. Exports generate foreign-exchange earnings, allow firms in developing countries to enter activities they could not have undertaken solely for their domestic markets, and help them build new productive capacity. Exports can also serve as a monitoring device for economic performance generally.

It is also clear that TNCs play a pervasive and prominent role in international trade and in the export competitiveness of many countries. Current developments in the global economy suggest that this trend is set to continue. Ever more intense global competition, driven by liberalization and technological change, offers opportunities for developing countries seeking to benefit from export-oriented FDI. TNCs respond to competition by cutting costs, increasing efficiency and innovating. As a part of this process, they now cast their nets much wider in search of new locations, increasingly encompassing developing countries.

The world economy is thus in a state of flux. Given the dynamic changes characterizing key export industries and the rising competition among countries and sub-national entities for export-oriented FDI, policy-makers face a tremendous challenge. Just as the firms they seek to attract are forced to make their production systems constantly more competitive, policy-makers too have to address the issue of upgrading. This applies to countries at all levels of development. Even traditionally significant recipients of export-oriented FDI need to keep moving up the value chain to sustain rising wages and to maintain their competitiveness as an export base.

Moreover, the potential benefits from export-oriented FDI cannot be taken for granted. A number of low-technology industries (e.g. textiles, clothing and footwear) on which many developing countries have relied in the past may have peaked, quota restrictions in the area of textiles and clothing industry are in the process of being phased out and preferential margins are being gradually eroded. Additionally, in some major recipient countries, export production by foreign affiliates remains strongly dependent on imported inputs, with only limited linkages to local suppliers of goods and services. Where economies of scale at the plant level, agglomeration economies, and close interaction between buyers and suppliers matter greatly, latecomers face a difficult task in competing with first-mover locations. Countries that manage to develop dynamic localized clusters of such industrial activity will be in a good position to benefit from inward FDI.

Policies to attract and benefit from export-oriented FDI should take into account changing corporate strategies and the increasingly competitive environment for promoting FDI. And countries (and sub-national entities) need to assess their potential role in the evolving international production systems carefully. There is no universal policy prescription that can be used by all countries, but there are some key factors to consider.

First, more and more countries recognize the need to undertake more *targeted* efforts to promote export-oriented FDI. The main advantage of a targeted approach is to improve the chance of attracting the type of investments that can help meet the development objectives of a country. Successful targeting involves a good understanding of the relative competitiveness of a host country (or a location within it) for specific activities, and a sound analysis of corporate strategies affecting the choice of location. In response to increased

geographical and functional specialization in many industries, countries may find it useful to identify production niches through which they can link up with global value chains. However, effective targeting involves more than just IPAs; it requires a co-ordinated effort by the host-country Government. At the same time, such an effort must be in tune with the industrial policy and overall development strategy of the country and the specific needs of the targeted export activity. Moreover, care must be taken that not all countries aim at exporting the same products, as this would result in oversupply and a subsequent deterioration of the terms of trade.

Second, *access to key destination markets* is a necessary – but not sufficient – condition for attracting export-oriented activities. While multilateral liberalization is eroding the preferential access on which some countries have relied, many regional and preferential arrangements still remain important, such as the European Union and its association agreements, NAFTA, the United States' Caribbean Basin Initiative and AGOA, as well as the various offshore production schemes. While policy-makers need to be aware of any opportunities arising from such arrangements, they need also to understand their limitations. For example, tariff schedules linked to offshore production schemes generally discourage the use of local components and may constrain the upgrading of local operations. Trade preferences provide neither a sufficient nor a sustainable basis for developing competitive export industries (with or without FDI). They need to be seen as affording a temporary window of opportunity that provides the requisite time to strengthen other locational advantages.

Third, in selecting the policy measures to be included in a package for investors, developing countries not only need to identify the most effective ones in a specific context, but also to ensure that they conform with the *international regulatory framework*, notably WTO rules. In this context, the role of export subsidies warrants special attention. The Agreement on Subsidies and Countervailing Measures (the SCM Agreement) stipulates that all export subsidies have to be phased out by the end of 2002, except by LDCs and other countries listed in Annex VII of the Agreement. Even those countries granted an extended transition period are not allowed to set up new forms of export subsidies and will need to develop appropriate post-transition policy responses. The implications may be particularly relevant for countries using EPZs, as export subsidies are very often an integral part of the incentive package offered in such zones.

This does not mean that EPZs will not continue to play an important role in the overall strategy of countries to promote export-oriented FDI. For example, countries will still be allowed to exempt exports by companies in these zones from indirect taxes (such as sales taxes), border taxes (e.g. consular fees) and import charges. Also, duty drawbacks and duty exemptions will still be permitted. Similarly, advantages in the form of well-functioning infrastructure and streamlined administrative procedures will remain unaffected. Partly in the light of this, a number of countries, including some developed ones, are turning their EPZs into industrial parks or science parks that can act as catalysts for cluster development (see below).

There is a risk of intense competition for export-oriented FDI translating into a *race to the bottom* (in social and environmental standards) and a *race to the top* (in incentives). Such concerns have been voiced especially in the context of EPZs. Successful EPZs should not be judged solely on their capacity to attract FDI or increase exports and foreign-exchange earnings. They should also be assessed by the extent to which they help meet broader economic and social objectives. Countries that pursue more integrated policy approaches for attracting export-oriented FDI – for example by encouraging tripartite representation (employers, workers and public authorities) on EPZ committees, guaranteeing workers' rights (including freedom of association and collective bargaining), and upgrading skills and work conditions – have tended to attract higher-quality FDI. Singapore and Ireland are two examples of countries that have pursued such integrated policy approaches. In both these countries, efforts were made to promote training, facilitate dialogue between labour and management, and provide first-class infrastructure for investors. They have demonstrated that good labour relations and the upgrading of skills enhance productivity and competitiveness.

With regard to the risk of an incentives race to the top, while the SCM Agreement generally prohibits the use of export subsidies, other incentives, especially locational ones, are still widely used in both developed and developing countries to promote export-oriented FDI. Increasing competition for export-oriented FDI risks accelerating the incentives race among competing locations and thus calls for further international cooperation to address this issue. The difference in resources available for public support to private investment also suggests that developing countries will continue to be at a disadvantage in such a race. A reduction of investment subsidies in developed and developing countries should help Governments allocate more resources for the development of skills, infrastructure and other areas that serve to attract export-oriented activities. At the same time, a case could be made for making certain development-oriented subsidies to foreign affiliates non-actionable under WTO rules, for example, if they serve to encourage the provision of technology, technical assistance and training to local suppliers and their personnel. However, to avoid free-riding, firms receiving incentives should be required to commit sufficient resources on a long-term basis.

Fourth, expanding exports is just a means to an end – to promote development. To benefit fully from export-oriented FDI and facilitate an upgrading of export-oriented activities, host countries need also to *encourage linkages* between the foreign affiliates and local suppliers. Export-oriented foreign affiliates – especially if operating in enclaves – often import all or most of their input requirements of components and raw materials, assemble the product in the host country, and then export their semi-finished or finished output. It is partly against this background that linkage promotion has become an increasingly important policy area. Linkages with foreign affiliates are a key channel for the diffusion of skills, knowledge and technology among domestic firms. Whereas a range of policy measures can be considered to promote linkages, the emphasis has shifted towards the use of instruments that address market failures and contribute to building local capabilities. Examples include information provision and matchmaking; encouraging foreign affiliates to participate in programmes aimed at upgrading domestic suppliers' technological capabilities; promoting the establishment of supplier associations or clubs; the joint provision of training; and various schemes to enhance domestic suppliers' access to finance (see *WIR01* for more details).[1] Meanwhile, as in other policy areas, linkage promotion strategies also need to adapt to the changing nature of corporate strategies. For example, in response to the globalization of the electronics industry, the Government of Ireland has abandoned the idea of promoting linkages only between Irish firms and foreign electronics affiliates present in Ireland and is instead promoting the participation of Irish firms in supply chains of TNCs based anywhere in the world (box VIII.14).

Linkages between domestic suppliers and foreign affiliate buyers can also take place more frequently if buyers and suppliers operate in the same spatial and industrial area. Indeed, the increasingly interdependent nature of policies on investment, trade, technology and enterprise development calls for a more integrated approach to fostering export-oriented FDI and economic development. As the development of infrastructure, business services and specialized skills often involve significant levels of investment, many countries have encouraged the formation of *localized industrial clusters*.[2] Such efforts seek to create conditions that will promote dynamic interaction, learning and competition among all relevant actors. Many countries that have seen improvements in their export competitiveness over the past two decades have hosted agglomerations of mainly foreign-owned producers. Prominent examples include Costa Rica, Ireland, Malaysia (Penang), Mexico, Singapore and a few countries in Central and Eastern Europe. However, not all export-oriented projects are good candidates for becoming nodes of dynamic industrial clusters. The chances of production concentrating in a limited number of locations increase when there are economies of scale at the plant level, relatively low costs per unit of output, low barriers to trade, and the presence of externalities and spillovers.

While the formation of industrial clusters can be spontaneous, resulting from the agglomeration of firms engaged in similar or related activities, increasingly, strategic government intervention can facilitate their creation. Three kinds of effort have been identified as essential for the development

of clusters involving inward FDI (Low, 2001). The first is *investment and business promotion* in a targeted manner (chapter VIII). Policy-makers need to understand the competitive needs of different industries to avoid encouraging investments to the wrong kinds of clusters; cluster diagnostics is therefore fundamental (Peters and Hood, 2000). Furthermore, there is a special need in FDI-based cluster development for close cooperation between IPAs and related government institutions. The second is *institution-building,* which is a complex process. Agglomeration tendencies can be encouraged by the establishment of EPZs, industrial parks and other specialized facilities, often specializing in one or more industries.[3] Such institutions as metrology, standards, testing and quality assurance (known collectively as MSTQ) provide the infrastructure of modern industrial activity. Their importance to competitiveness is growing with increasingly stringent quality, precision, tolerance and other standards in international markets. Other relevant institutions are those responsible for initiating research, providing access to financial resources, and creating business networks and professional associations.[4] Obviously, depending on the cluster, some institutions will be more important than others. The third element focuses on the *training and upgrading of human resources*. For knowledge-based activities, in particular, training and upgrading of relevant human resources is key. While this aspect is addressed mainly through the education system in general, it is sometimes necessary to make specific and targeted efforts to ensure a sufficient supply of qualified people. Such efforts may involve the establishment of specialized training centres, possibly with the involvement of foreign affiliates.[5] Another

Box VIII.14. Promoting supplier transnationalization

To remain competitive as a supplier, firms are increasingly required to supply their outputs at the regional or even global levels. The presence of foreign affiliates in a host economy can be used as a vehicle to facilitate such a transnationalization process of domestic firms.

The transnationalization of local suppliers – by way of either increased exports or FDI – is more likely to occur when domestic collaboration between suppliers and investors is not only high but also involves high-value-added activities. Factors that influence the likelihood of transnationalization include the complexity of the production process, the level of local procurement by foreign affiliates, the autonomy and mandate of foreign affiliates, and the importance of geographical proximity between investors and suppliers (Raines, Turok and Brown, 2001).

Some authorities have taken these aspects into account and designed special measures to benefit from the presence of export-oriented foreign affiliates with a view to strengthening the international operations of domestic supplier firms. In Scotland, for example, Scottish Enterprise has set up a Global Connections Strategy, a key aim of which is to increase the benefits from inward FDI and facilitate the emergence of internationally more competitive Scottish firms. The Strategy covers the activities of Locate in Scotland (the IPA), Scottish Trade International, the Globalisation Team and Scotland Europa (Raines and Brown, 2001).

The Irish case is also illustrative. In the latter half of the 1990s, TNCs in the electronics industry increasingly required their Irish suppliers not only to supply their Irish affiliates, but to do so also on a regional or global scale. In response, Enterprise Ireland, the government agency responsible for SME development, set up an "International Business Linkages Division" in 1998 with the purpose of supporting the transnationalization of the Irish supplier industry. The initiative was a joint endeavour with the national export board and offers the following activities (Ruane, 2001):

- Assistance to local companies in finding global partners;
- Encouraging international companies to purchase local companies that could not succeed on their own, and to ensure that local plants can continue to operate in Ireland;
- Assistance to local suppliers engaged in electronics sub-supply to find international markets, often piggy-backing on the parents of affiliates who source locally;
- Assistance to internationally successful Irish suppliers in finding cheaper sources of inputs in Central and Eastern Europe, in areas in which the Irish cost base is threatened; and
- Assistance to successful local companies in transforming themselves from being sub-suppliers to being sub-assemblers.

Source: UNCTAD.

approach is to attract internationally mobile skills to complement the local skills base. In general, the more knowledge-intensive the activity, the more important it becomes for clusters to attract skills.

The bottom line is that the degree of success of a host country in attracting and upgrading export-oriented FDI, and in reaping development benefits from such investment, critically depends on its ability to develop the domestic resources. Indeed, some of the countries most successful in boosting export competitiveness and leveraging export-oriented FDI practised a two-pronged approach, based on developing domestic capacities while targeting foreign resources. Perhaps the most visible example is Singapore, which implemented a comprehensive strategy to target foreign investors in critical export-oriented and high-technology activities. The broad contours of this strategy include the following elements (Felker, 2002; Low, 2001; Mathews, 1999; http://www.sedb.com; Lall, 2000a):

- The establishment of a top agency to oversee FDI targeting, in line with the country's broader development and industrial strategies;
- An evolving package of targeted incentives to encourage TNCs to invest in strategic (typically export-oriented) activities;
- Harnessing the presence of TNCs and partnerships with foreign Governments to develop and upgrade a highly flexible and responsive human resource system;
- The development of world-class infrastructure, including science parks to host foreign research units;
- The establishment of capital investment funds to partner with foreign companies in strategic investments; and
- Targeted support for the development of domestic enterprises, and for suppliers and clusters (box VIII.15).

Other Asian countries, and Malaysia in particular, have followed the Singapore model, but none has been as sucessful, mostly

Box VIII.15. Cluster development: the case of Singapore

In Singapore, the Economic Development Board (EDB) has been the lead agency in cluster development, complemented by a number of important institutions responsible for key areas. Examples include the International Enterprise Singapore, the National Computer Board, the Standards, Productivity and Innovation Board, and the Agency for Science, Technology and Research. In addition, some Government-linked companies have also played an active role.

For example, the electronics cluster, which has evolved from consumer electronics via industrial electronics to semiconductors, has been reinforced by wafer fabrication, undertaken by the Singapore Technologies group, a Government-linked company (Low, 2001). The EDB played an instrumental role in creating three specialized "wafer fabrication parks".[a] Each park is supplied with specialized power and water supply systems and waste treatment facilities, as well as high quality land and ancillary services. Through its Cluster Development Fund[b] the EDB took equity stakes in wafer fabrication jointly with (among other companies) Texas Instruments, Chartered Semiconductor Manufacturing, Hitachi/Nippon Steel, and Philips.

The National Science and Technology Board has played the role of coordinator of R&D activities such as in the establishment of the Centre for Wireless Communications, the Gintic Institute of Manufacturing Technology, the Institute of Microelectronics and the Magnetics Technology Centre (Mathews, 1999).

These initiatives were supported by major efforts to build the skills needed for technology-based industrialization. In 1979, the Government set up the Skill Development Fund, along with a Skill Development Fund Levy of 1 per cent of payroll from employers. Money from this Fund is disbursed to firms that send their low-paid workers to approved training courses. Meanwhile, the university system has been expanded and directed to meet the needs of the country's industrial policy. A Vocational and Industrial Training Board, established in 1979, has trained and certified more than 110,000 individuals since its inception in various fields relevant to industry needs. These and other measures have resulted in an upgrading of skills; the proportion of professional and technical workers rose from 16 per cent in 1990 to 23 per cent in 1995 (Lall, 2000a).

Source: UNCTAD.

[a] The parks are located in Woodlands, Tampines and in Pasir Ris (Mathews, 1999).
[b] This Fund has three purposes: to facilitate investments in strategic projects that enhance core capabilities of local industry clusters, to accelerate the development of local enterprises, and to undertake strategic investments with local companies and TNCs to strengthen Singapore's regional links (Mathews, 1999).

because of an inability to build strong domestic capacities and linkages. The latecomers have yet to fill the gap between the sophisticated nature of their export structures and the rather weak base of domestic skills and technological capacity. While high-technology FDI has not been particularly footloose, it may well place its most dynamic and skill-intensive new technologies elsewhere if old bases are unable to meet growing needs.

In conclusion, the continuous need for countries to move up the ladder and improve the attractiveness of their locational advantages is a challenging task for policy-makers in developing countries, and calls for sophisticated and comprehensive policy approaches. Moreover, given the potential of improved export competitiveness as a vehicle for promoting development, the need of developing countries to preserve sufficient policy space to pursue their development objectives has to be recognized. Finally, although the extent to which developing countries can profit from new opportunities created by the emergence of international production systems depends primarily on their own actions, developed countries can also help in a number of ways. Such efforts include the provision of assistance for the development of institutional capacity, dissemination of information about export-oriented investment opportunities in low-cost locations, and the dismantling of barriers to exports from developing countries. Meanwhile, a rise in protectionism could, in effect, jeopardize the prospects for poor countries to exploit their comparative advantages fully. The growing use of the anti-dumping weapon, increased tariffs on certain products, and the expanded use of targeted subsidies in developed countries all give cause for concern in this context.

Notes

1 Some countries have taken a more comprehensive approach and established specific linkage promotion programmes. Costa Rica, the Czech Republic, Hungary, Ireland, Malaysia, Singapore, Thailand and the United Kingdom have all made special efforts of this kind, either at the national or the regional/local level (*WIR01*).

2 According to one definition, clusters are geographic concentrations of interconnected companies and institutions in a particular field (Porter, 1998, p. 58).

3 In China, for example, hundreds of industrial parks have been developed with the active support of local authorities. In Shanghai, some of the many industrial parks and special economic and development zones are highly specialized, including the Shanghai AIC Modern Agriculture Park, the Shanghai Chemical Industry Park and the Shanghai Xinzhuang Industry Park. The last focuses on information technology, electric appliance and automotive components, biological medicine and new materials.

4 For example, a key element in the cluster-oriented approach of Scottish Development International has been to develop various forums to facilitate interaction and networking between the different actors. Clusters have been promoted in oil and gas, food and drink, forestry, micro-electronics (including opto-electronics), semiconductors, biotechnology, and services such as tourism and software (Scottish Enterprise Network, 2001).

5 Many industrial parks and special economic zones in China boast the availability of universities and research institutes in their vicinity that provide training to specialized technicians. The Penang Skills Development Centre in Malaysia plays an important role in putting together training courses contributed by TNCs to upgrade skills in the supplier workforce. In Singapore, public-private cooperation for training is an important part of the Local Industry Upgrading Programme (*WIR01*).