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Attracting High-Quality Foreign Direct Investment to Developing Countries

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ABSTRACT:A foreign direct investment (FDI) is an investment made by a firm or individual in one country into business interests located in another country. Generally, FDI takes place when an investor establishes foreign business operations or acquires foreign business assets in a foreign company. This paper studies how high quality FDI can be attracted to developing countries

I.INTRODUCTION

Foreign direct investment (FDI) in developing countries has a bad reputation. In some discussions, this appears to be tantamount to postcolonial exploitation of raw materials and cheap labor. However, recent data show that FDI in developing countries is increasingly channeled into the manufacturing industry with medium and high skills, which is associated with higher income levels (figure 1). Moreover, the growth of many emerging economies is based on foreign direct investment flows.

Quality FDI

The trick is to attract "quality FDI" that link foreign investors to the local economy of the host country.

Quality FDI is characterized as:

・promoting the creation of value-added decent jobs;

・advanced training in host countries;

・promoting the transfer of technology, knowledge and know-how;

・increasing the competitiveness of domestic firms and providing them with access to markets; and

・acting socially and environmentally.

To achieve this, host countries cannot simply wait and see what international market forces can bring them. Rather, they need tailored policies to overcome internal shortcomings that hinder the smooth integration of local and foreign companies into global supply chain networks.

Recent studies offer evidence of developing country strategies that have successfully turned FDI into quality FDI. The idea behind the following suggestions is to learn from experience.

Strategies for attracting quality FDI

• Open markets and the possibility of inflow of foreign direct investment. Reduce restrictions on FDI. Providing an open, transparent and reliable environment for all types of firms, both foreign and domestic, including: ease of doing business, access to imports, relatively flexible labor markets, and protection of intellectual property rights.

• Create an Investment Promotion Agency (IPA). A successful IPA can target suitable foreign investors and then serve as a link between them and the domestic economy. On the one hand, it should act as a one-stop-shop for the demands that investors place on the host country. On the other hand, it must act as a catalyst in the host country's domestic economy, encouraging it to provide first-class infrastructure and easy access to the skilled workers, technicians, engineers and managers that may be required to attract such investors (Moran, 2014; Barnes et al. , 2015; Harding and Javorcig, 2012). Moreover, it must engage in post-investment care, recognizing the demonstration effect of satisfied investors, the potential for reinvestment, and the potential for cluster development due to subsequent investments. ...

• Think carefully about the sectors / activities that the target will target. Investment and placement decisions by suppliers may be influenced by the decisions of major multinational investors in the host country (McKinsey, 2001; Javorcik et al., 2006).

II.LITERATURE REVIEW

・Build the infrastructure needed for a quality investor: for example, a sufficient number of vehicles nearby (airport, ports), adequate and reliable energy supply, provision of skilled labor, training opportunities for specialized workers ideally designed in cooperation with the investor (Ibid).

・Strengthening feedbacks between FDI and the local economy. Allow the competitive pressure of foreign participants on their local suppliers in order to increase their competitiveness (Rhee et al., 1990) and allow various forms of direct assistance from foreign companies to domestic firms in the form of training, assistance in setting up production lines, coaching managers regarding strategy and financial planning, financing, quality control assistance and export markets (Javorcik and Spatareanu, 2005; Blalock and Gertler, 2008; Godart and Görg, 2013; Görg and Seric, 2016).

・Encouraging the flow of FDI to the local economy. Local firms, created by managers who started in multinational companies, are more successful and productive than others (Görg and Strobl, 2005). Managers in local firms gain knowledge of new technologies and marketing methods by studying and imitating their multinational competitors (Javorcic and Spatareanu, 2005; Boly et al., 2015). Likewise, moving workers from multinational to local firms spreads knowledge and skills.

・Encourage new foreign direct investors. Foreign firms that are not yet part of an extensive network of subsidiaries are more willing to accept links with domestic suppliers (Amendolagine et al., 2015).

・Encouragement of direct foreign investors from among the members of the diaspora. They are also more likely to foster linkages with local firms and facilitate the internationalization of the host country (Boly et al., 2014).

・Provide access to credit by reforming domestic financial markets. Creating a business-friendly financial system helps local companies to respond to challenges and impulses from foreign participants, independently choose supplier status and thereby grow and prosper (Alfaro et al., 2009)

・Create a supplier development program to support the agreement process between the foreign customer and the local supplier. To strengthen the capacity of the national economy, it can offer financing opportunities to local suppliers for the necessary investments through purchase contracts with foreign buyers (see Singapore's Local Industry Upgrade Program (LIUP)) or pay compensation of a manager in an overseas factory who is looking for talent among domestic suppliers (see the example of the Economic Development Board of Singapore).

・Design export processing zones (EPZs) to be part of the domestic economy. Avoid EPZ rules that discriminate against local supplier relationships. Create a secondary industrial zone for local suppliers, be it a geographic location adjacent to formal export zones, or as a legal status that allows easy foreign-domestic links, such as databanks and "marriage consultants" to assist in supplier selection (Moran et al., 2016).

・Refocus on the topic "Who are we?" adequately consider and solve the related problems. “Us” should be understood as the most profitable firms for the domestic economy, regardless of the nationality of their owners. Therefore, firms that create highly skilled and highly paid jobs, the least expensive products, and the most competitive exports are considered “us” (Reich, 1990).

・Be patient and look forward to a gradual structural transformation of the domestic economy. Investors can come in waves. For example, first investors in thermionic lamps, valves and transistors, then in television and radio systems, and finally in computers, computer peripherals and data processing systems. Along with this, foreign direct investment can contribute to the diversification and modernization of domestic production (Amendolagine et al., 2013; Moran, 2014; Barnes et al., 2015).

Caution notes

・Do not insist that all domestic FDI is carried out at the most difficult technical level. International firms with mid-range technology can provide advantages and connect with local suppliers whose capabilities are more in line with foreign firms (Boly et al., 2015; Pérez-Villar and Seric, 2015).

・Do not confuse supply chain creation with SME support. Medium and larger local companies are often more likely to establish mutually beneficial relationships with foreign investors than their smaller partners (UNCTAD, 2011).

・Don't subsidize certain companies. Government support should take the more general form of creating a reliable infrastructure and offering specialized vocational training.

III.ANALYSIS AND RESULTS

The underlying theme of ThefDi Report 2020 - the annual assessment of crossborder investment based on fDi Markets, a service from the Financial Times – is that greenfield foreign direct investment (FDI) largely remained stationary.
The fDi Report 2020 reveals that greenfield capital investment decreased by 15% to $795.7bn, while the number of FDI projects reached 15,558, compared to the 15,561 recorded in 2018. Job creation declined 5% to 2.2 million.
Key FDI trends spotted include:
The US replaces China as the highest ranked country for inward FDI by capital investment
Western Europe is the leading source region for FDI in 2019, with $300.5bn in capital investment
The UK is the top destination for FDI in Europe, with a total of 1,271 projects in 2019
The number of FDI projects from China into the US declines by 51%
FDI into Africa by number of projects grows 49% to 998

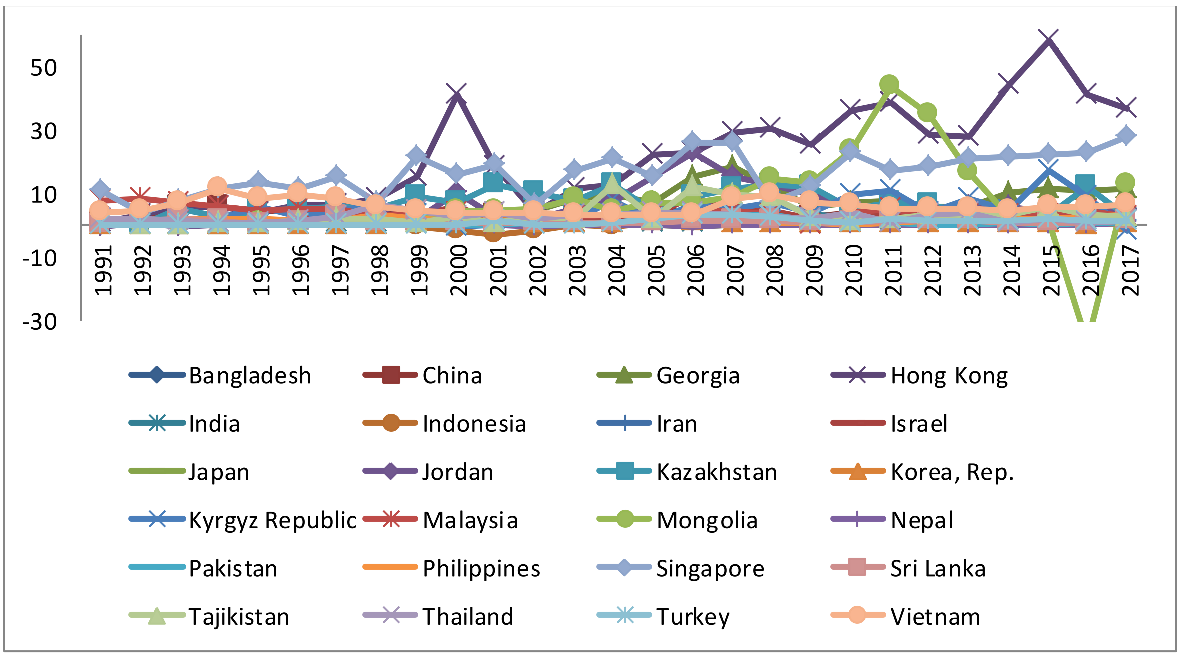

Figure 1. Foreign direct investment, net inflow (% of GDP) by selected Asian countries
Source: World Bank

Figure 1 shows that there are many year-to-year fluctuations, and the net inflow of FDI (% of GDP) also varies significantly across countries.

IV.CONCLUSION AND FUTURE WORK

· External donors such as developed countries and multilateral financial institutions continue to play a vital role in supporting developing countries. The explosive growth in international private sector investment has not obviated the need to support growth and development programs in developing countries, even beyond relief and poverty reduction programs.

· Developed countries need to improve the functioning of financial markets around the world to enable developing countries to use their FDI. For example, better financial market institutions, even in FDI source countries, help bridge financial market deficits in host countries, thereby increasing FDI flows to developing countries (Görg and Kersting; forthcoming, Donaubaueret al .; 2016).

· Developed countries should step up support for the effective promotion of foreign direct investment in developing countries. Actively targeting large investors in certain sectors requires specialized and costly expertise on the part of the

IPA, with professional staff earning internationally competitive salaries that can be borne by external donors. Moreover, developing countries need help learning how to effectively use the IPA to market their countries to multinational investors.

The essence of the proposals is to advocate an easy form of industrial policy: a policy that seeks to link FDI to development goals and create as deep feedbacks as possible in the host economy. The evidence presented here shows that progress in developing countries can be achieved without significant levels of protection or significant levels of direct support by focusing on quality FDI.

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