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The Effectiveness of Promotion Agencies at Attracting Foreign Direct Investment

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Jacques Morisset
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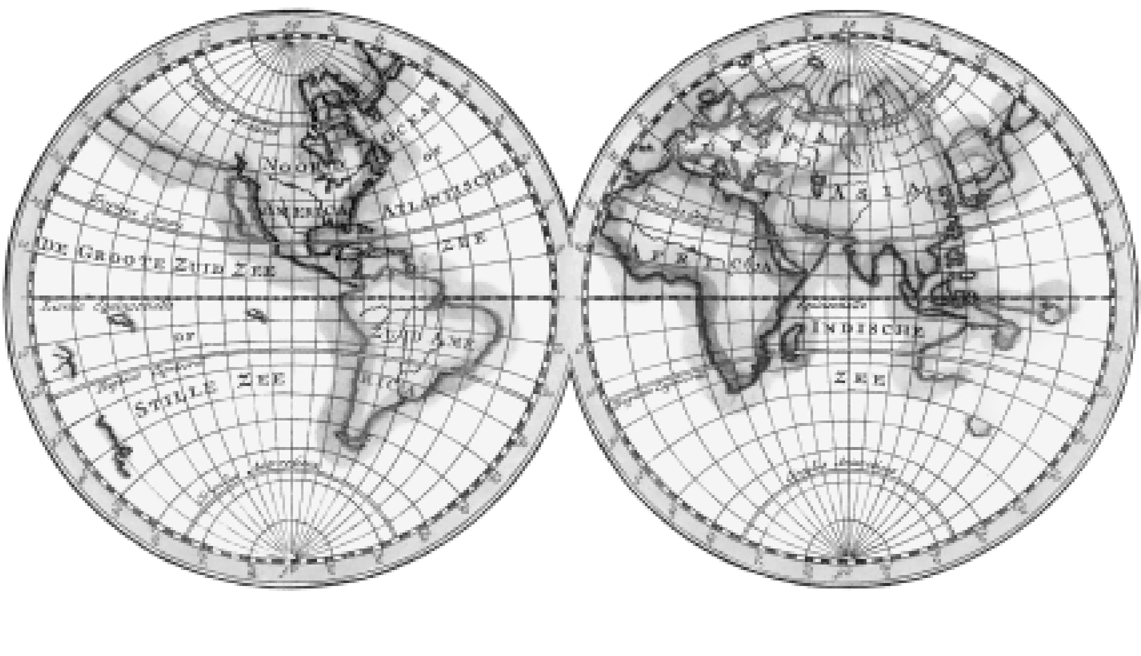

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16

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Foreword

With many millions of dollars being spent annually by governments on promotion to attract foreign investors to various countries, a perplexing question has become increasingly important: Does investment promotion really work? Jacques Morisset and Kelly Andrews-Johnson have made a major step in providing a convincing answer to this and associated questions.

So far, these expenditures, overwhelmingly by governments, have been largely an act of faith. In writing *Marketing a Country*,[1] Alvin Wint and I, both now business school professors, assumed that this was an act worth the gamble. Our business school training had convinced us that a company wanting to sell its output will have to undertake some kind of marketing program to bring its product to the attention of consumers, inform them of its advantages, and create a favorable "brand image." Sure, how much to spend and on what kinds of activities are frustrating business questions, but marketing is essential. Similarly, we largely took it for granted that most countries would have to do some marketing if they wanted to attract investors from abroad. Some potential investors might know little about the investment locations, could have no idea of policy changes recently made, and could use some personal attention in their quest for an investment site. However, others, especially economists and government officials who control budgets, have been less sanguine about the benefits of promotion to a country. To be sure, our *Marketing a Country* purported to address the question of whether promotion paid, but almost as an afterthought. The statistical work in that study involved data from around 1985. Many countries were just beginning to revise national policies to reflect the growing view that attracting foreign investment was a very good thing. Because many countries were not yet trying to promote investment, we could conduct a very simple test: compare foreign direct investment (FDI) flows into countries that had promotion activities in the United States with the flows into countries that didn't. Of course, we tried to control for other variables that had been shown to affect FDI, in particular gross national product (GNP) per capita, inflation, and a country's current account. The study provided some crude support for the idea that promotion worked and, with some heroic assumptions, that the cost of promotion per job created was around US$400–600. The costs of attracting an investor seemed about equivalent to what perhaps 6 months of income tax holiday—another way of attracting investment—might cost a country. Put this way, the tradeoff seemed to favor promotion. But our data came from more than 15 years ago: The independent variable was simply whether promotion was undertaken or not, and we had no indicator of the size or kind of the promotion effort of individual countries. The methodology was crude, and the results simply could not address a number of questions that are important for policy.

Morisset and Johnson offer us much more recent and rich data from their survey, and they use a more sophisticated methodology. As a result, their study is more convincing and addresses many more questions than earlier work. The authors collected data on the amount of resources 58 promotion agencies devoted to particular promotion activities and on those agencies' organization and financing. The results are comforting and consistent with earlier findings that promotion does work. The authors could go further than earlier work, however, and calculate elasticities: on average, an increase of 10 percent in promotion expenditures seems to yield a 2.5 percent increase in FDI. Or—in terms that are perhaps easier to interpret—for the median country, an additional expenditure of US$60,000 on promotion yields about a US$5 million increase in FDI. Morisset and Johnson find the median expenditure on investment by developing countries to be smaller than one might have expected; even relatively small expenditures, however, can be worthwhile. However, the study shows that expenditures below a certain annual level yield few if any returns.

Equally important, the richer data enabled the authors at least to suggest answers to questions about which particular kinds of promotion efforts yield the highest returns to money (and time) spent. The results are a bit surprising: expenditures on policy advocacy are at the top of the list of high returns, and efforts at so-called investment-generating activities produce the smallest return per dollar spent.

Of course, the results are reported for the "typical" (or median) investment promotion agency. The authors would strongly argue that a country should not mechanistically apply their findings without considering the problems and strengths of the particular country. Where the investment climate is bad, efforts to improve policy seem sensible; it is helpful to have these results showing that the expenditures on policy advocacy do work. In fact, in countries with very poor investment climates, returns to expenditures on other promotion activities are likely to be especially low. It may also be the case that image building has a lower return for large countries that are already well known and regularly tracked by investors than it does for small, little-known places. Similarly, it is likely that promotion has more impact on certain kinds of investors than on others, but the study doesn't quite answer questions at this level of detail. In the end, even with the large sample covered in the survey, sample size and other limits on the availability of data constrain conclusions from statistical analysis.

The research says some important things about organizational issues. The results show that agencies with some kind of participation from the private sector do better than those that are purely governmental, for example. The opposite is also probably true: strictly private sector agencies are unlikely to work terribly well. Purely private agencies are, however, so rare that the study couldn't really demonstrate this point. It did provide data that supported the idea that promotion agencies work better if they are not part of a ministry, however—it's better to report to the president's office, for example.

This study goes a long way in addressing questions of importance to policymakers, much further than anything done before. Yet, like any research in a really messy area, this study by Morisset and Johnson doesn't convincingly tell a reader everything he or she would like to know. Inevitably, the results can be challenged based on the possibility that promotion efforts are so correlated with other policies designed to attract investment that we are observing not only the impact of promotion, but also the effects of those other policies. In statistical analysis, there is no completely satisfactory way to disentangle the effects of policies that so often come as a package. But the correlations in this study are so strong that it is hard to believe that promotion is not playing a significant role. Moreover, anecdotal evidence, such as that offered by Debora Spar, provides a great deal of confidence that Morisset and Johnson have it right. The detailed stories give examples and, more important, illustrate the mechanisms through which promotion works in influencing foreign investment decisions.[2]

One seemingly important question is not addressed at all in this study: Does promotion increase the total flow of foreign investment, and how much, or does it divert investment that would be made anyway, simply leading it to the country that does more or better promotion and away from another country? As interesting as the question is, the answer probably doesn't really matter. To be sure, if promotion fails to increase the total amount of investment, then the world would be better off if no one spent resources on promotion. However, any global agreement—and probably any regional agreement—to limit investment promotion is highly unlikely. The problems of distributing the gains from such an accord, if there are gains, are formidable, and they are not likely to be overcome in the time horizon of any readers of this research.

In spite of its small and inevitable problems, this research, as well as the many anecdotal pieces of evidence that are accumulating and arguments by analogy to the needs of businesses to market their products, all add a great deal of credibility to the conclusion that investment promotion is worthwhile. For many businesses, marketing is a more profitable expenditure than engaging in a price war by cutting prices. For a country, the equivalent of cutting prices is offering incentives, either tax breaks or direct subsidies. This study provides more evidence to suggest that, at least for many countries, a dollar spent on investment promotion yields a better return than a dollar provided as a subsidy or a dollar given up through a tax incentive program. Moreover, this study has many lessons about how to carry out effective investment promotion. I do not want to reveal all of those lessons here in the preface—a simplistic summary should not serve as a substitute for reading this outstanding piece of research and ferreting out the rich lessons as they apply to individual countries.

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May 20, 2003

Preface

Since 1985, the Foreign Investment Advisory Service has assisted more than 100 countries around the world in their efforts to attract more and better foreign direct investment. A close relationship with investment promotion agencies has been developed as part of this effort. This study aims at providing some guidance to policymakers and managers of these agencies that are interested in understanding the conditions—both external and internal to these agencies—that may make them more effective in influencing the location decision of multinational firms.

We are especially grateful to Professor Louis Wells from the Harvard Business School, who was essential at various stages of this project. Professor Wells has not only contributed to our knowledge of the role of promotion agencies around the world, but he has also provided us with continuous encouragement. We also benefited from the comments of Joseph Battat, Frank Sader, Neil Roger, Joel Bergsman, Dale Weigel, David Bridgman, Simeon Djankov, Teresa Andaya, and participants at the Annual Conference of the World Association of Investment Promotion Agencies (WAIPA) in Geneva on January 22–23, 2003.

Anne Miroux and Alejandro Alvarez contributed to the realization of the survey of about 100 investment promotion agen-

cies conducted by the Foreign Investment Advisory Service (FIAS) between February and May 2002. We thank all the individual agencies that responded to our numerous questions, as well as the Investment Marketing Services unit of the Multilateral Investment Guarantee Agency (MIGA) and WAIPA, that have supported this project since its beginning. Finally, Nicole Smith provided technical assistance for the database and the statistical analysis.

1

Overview

Mr. Smith, general manager of a U.S. firm, became interested in investing in West Africa. His interest arose from a series of advertisements in the *Financial Times* and from several websites praising the advantages of these countries, such as: “Ivory Coast: The Best of New Markets,” “Senegal: The Perfect Choice,” or “Niger: A Country Open to Your Investment.”[1] Partially convinced, Mr. Smith traveled to Africa and was welcomed by the local investment promotion agency, which responded to his multiple enquiries. In the end, Mr. Smith opened a subsidiary in one of these countries. He did not forget to thank the investment promotion agency, which played a pivotal role.

A similar story could be told about Mr. Smith in Singapore, Dublin, Dar es Salaam, or Riga. Establishing an investment promotion agency (IPA) has become a central part of most countries’ development strategies. Today, there are more than 160 national IPAs and more than 250 subnational ones worldwide.[2] This trend is relatively new—only a handful of these agencies existed 20 years ago.

Currently, little is known about these agencies’ activities, especially in developing countries. For example, what volume of resources do countries spend on investment promotion? What are the main activities of the IPAs? To what extent is the private sector involved in the promotion effort? What are the institutional links between IPAs and governments? The standard cited most frequently for best practice in IPAs is based largely on the experiences of a few countries, mostly from industrial countries. Ireland's Industrial Development Agency (IDA) and Singapore's Economic Development Board (EDB), in particular, top the list as models.[3] However, there is much to be learned about current practices in developing countries and whether their IPAs have been able to fulfill the expectations of policymakers.

Due in part to a lack of reliable data, no broad empirical study of investment promotion agencies and their effectiveness in attracting foreign direct investment (FDI) has been done to date.[4] This empirical gap means that the debate on the effectiveness of IPAs is still very open. Critics of promotion have questioned whether the successes of a few IPAs can be replicated elsewhere and whether resources made available to these agencies are a good use of public resources. In the critics' view, there is a danger that investment promotion has become the latest fad among countries, especially developing ones, that are pinning unrealistic expectations on this tool's performance.

The main question that we have tried to address is: To what extent does investment promotion help explain cross-country variations in FDI flows? We use data from a new survey of 75 IPAs that was conducted between February and May 2002.[5] At the outset, it should be emphasized that our research should be viewed as a first step toward filling the existing empirical gap, and it has some obvious limitations. The most important is that we have been able to examine empirically the relationship between promotion and FDI only for the year 2001. Unfortunately, data are simply not available for additional years. We believe that the study nonetheless provides some answers to four sets of questions that should help IPA managers and policymakers develop a better understanding of the conditions—both external and internal to the agency—that influence the effectiveness of promotion:

- How does the amount of spending on investment promotion affect its effectiveness? Does an agency need to exceed a minimum level to have any effect on international investors?
- To what extent does the business environment or the country's characteristics affect the effectiveness of investment promotion? Does the quality of the general business environment matter?
- Does the effectiveness of investment promotion vary according to the functions or activities on which it focuses? Should an IPA devote more resources toward policy advocacy or image building?
- Is the effectiveness of investment promotion influenced by different agencies' characteristics, such as their structure, mandate, sources of funding, and institutional relationships?

This study looks at the effectiveness of IPAs in terms of the association between their promotional spending and FDI. It aims at capturing trends and stops short of the detailed cost-benefit analysis needed to fully evaluate IPA effectiveness. The results of our investigation show that investment promotion partially explains cross-country variations in FDI flows, suggesting that IPAs were effective in influencing Mr. Smith's decision to invest in the example given at the beginning of this chapter (box 1.1). Of course, as for similar results derived from cross-country regressions, this finding should be interpreted with caution. There are many problems in doing such an evaluation, especially the limited number of observations used in our analysis and the possibility that both promotion and FDI could be responding simultaneously to other factors.

Still, our results show that, on average, spending by IPAs was positively associated with attracting FDI, along with the influence of key factors such as the quality of the investment climate and the country's market size. They were also effective despite being small and having a narrow scope of responsibilities.

Box 1.1 Key Findings

- Greater promotion is associated with more FDI, along with the influence of the market size and quality of the investment climate.
- The IPA budget needs to be beyond a minimum level to exploit the increasing returns associated with most promotion activities.
- IPA effectiveness strongly depends on the country's business environment. It is positively correlated with the quality of the investment climate and the level of development.
- Countries with relatively few assets, as reflected by poor investment climates or low levels of development, get better results from improving these conditions than from spending limited resources on investment promotion.
- Policy advocacy appears to be the most effective function, followed by image building and investor service. Investment generation is not associated with higher FDI flows, even though it absorbs the greatest share of most IPA budgets.
- Strong reporting mechanisms to the highest political level, as well as participation by the private sector, contribute to increasing the IPA's visibility and credibility and thus reinforce effectiveness in attracting FDI.

Although most IPAs have very small budgets, we observed that size, nonetheless, does seem to matter (box 1.2). There are minimum levels of IPA expenditures, which explain cross-country FDI flows. Perhaps the agency must be of a certain size to be on the "radar screen" of potential investors.

The finding that promotion is associated positively with FDI has to be qualified. Mr. Smith in our example would not have been convinced by the IPA if the country's investment climate had been unattractive. A similar relationship exists with respect to a country's level of development, as measured by the income per capita. These results suggest that promotion should be con-

Box 1.2 Snapshot of a Typical IPA in a Developing Country

A typical IPA in a developing country is relatively new, created less than 10 years ago, by either a decree or a law, and it is constituted as a public body, as part of a ministry, or as an autonomous agency. It usually reports to a minister, a board of directors, or both.

Most often, its mandate goes beyond FDI promotion and includes domestic investment and export promotion. Still, IPAs rarely undertake the primary responsibility for privatization of key sectors of the economy—such as mining, agriculture, and special economic or industrial zones—thus limiting capacity to attract FDI in these areas.

The median developing country agency has a budget of under US$450,000 and employs 10 professional staff. IPAs in developing countries typically concentrate most financial resources on image building (38 percent of spending), followed by investment generation (29 percent), investor services (25 percent), and policy advocacy (8 percent).

sidered as a complement to—rather a substitute for—policies that create an attractive investment climate. Indeed, we believe promotion alone can even be counterproductive in a country that offers a poor investment climate. It seems more difficult to convince investors to come back if they were disappointed or disillusioned during their first visit to a country. Disappointed investors are also likely to be vocal about their disenchantment, which discourages other potential investors. Thus, policymakers should focus their efforts on improving the country's fundamentals rather than spending resources, both financial and human, on investment promotion when these fundamentals are not in place or far from international standards.

Not surprisingly, the scope of activities that an IPA undertakes influences performance. Following Wells and Wint (2001), we distinguish four key functions: policy advocacy, image building, investor services, and investment generation (box 1.3). Our empirical results suggest that policy advocacy is most associated with attracting investment, followed by image building and investor services. Investment generation appears to be the least cost effective, partly because it is expensive and partly because it is often not adapted to the reality of our sample of countries that have relatively poor investment climates and low levels of economic development. Of course, the optimal budget allocation to each function depends on the specific country, but our results suggest that most agencies would gain by devoting more attention to policy advocacy. This function remains the least favored by most agencies, accounting for only 7 percent of their budgets on average, compared to more than 33 percent for investment generation activities. The returns to increased effort on improving policy appear to be high enough to justify more effort.

Certain characteristics of IPAs are associated with greater effectiveness in attracting FDI. Political visibility and participation of the private sector appear to be two elements that are associated with success of IPAs in attracting FDI. Political visibility is best attained when the agency is linked directly to the highest government officials (for example, the president or the prime minister), but fewer than 10 percent of the surveyed agencies have been able to establish such links. Private sector involvement can be secured through participation in the board that supervises the agency. A board with private representatives is used by about half of the surveyed agencies. Mr. Smith, our private investor, was convinced more easily to invest by an agency that benefits from the support of the private sector, because this tends to increase the credibility of promotion efforts.

Box 1.3 Main IPA Functions

Image building creates the perception of a country as an attractive site for international investment. Activities commonly associated with image building include focused advertising, public relations events, the generation of favorable news stories by cultivating journalists, and so on.

Investor facilitation and investor services refer to the range of services provided in a host country that can assist an investor in analyzing investment decisions, establishing a business, and maintaining it in good standing. Activities in this area include information provision, "one-stop shop" service aimed at expediting approval process, and assistance in obtaining sites, utilities, and so on.

Investment generation entails targeting specific sectors and companies with a view to creating investment leads. Activities include identification of potential sectors and investors, direct mailing, telephone campaigns, investor forums and seminars, and individual presentations to targeted investors. Investment generation activities can be done both at home and overseas.

Policy advocacy consists of the activities through which the agency supports initiatives to improve the quality of the investment climate and identifies the views of the private sector on that matter. Activities include surveys of the private sector, participation in task forces, policy and legal proposals, and lobbying.

2

Are Investment Promotion Agencies Effective at Attracting Foreign Direct Investment?

Nearly every country has established an IPA as part of its strategy to attract FDI. When governments use these agencies to promote economic development, they need to evaluate if they get "the bang for their buck," yet very little research on this subject exists. Surprisingly, it also stands out from our survey that most IPAs do not report any attempt to evaluate the contribution in the country's effort to attract more FDI.[6]

In this chapter, we evaluate whether investment promotion affects inflows of FDI across a relatively large set of countries. Although this chapter presents the broad findings, it does not deal with the important issues of the conditions that make promotion especially effective (or ineffective) or what promotion activities seem to matter the most for FDI. The overall findings indicated, however, that promotion seems to make a difference.

An initial word of caution is necessary. Our research does not aim to justify the theoretical underpinnings of adopting investment promotion policies to attract FDI. Wells and Wint (2001) provided those arguments (box 2.1). Our empirical analysis should be viewed simply as a complement to this conceptual framework.

Measuring IPA Effectiveness

For most countries, the effectiveness of a promotion agency is measured by its capacity to attract (foreign) private investment. At the outset, it should be noted that some sophisticated IPAs try to do more: some aim at increasing the quantity as well as the

Box 2.1 Why Investment Promotion Is Useful: Analytical Arguments

Wells and Wint (2001, p. 4) define investment promotion as "activities that disseminate information about, or attempt to create an image of the investment site and provide investment services for the prospective investors."

This definition encapsulates the two most important analytical justifications for IPAs. The first is its role in communicating and disseminating information. Because this can be considered as a public good, it is possible that the private sector behavior will not lead to the optimal social welfare. As a matter of fact, local firms may voluntarily restrict information flows to prevent the entry of new potential competitors. Promotion campaigns provide an important mechanism for communicating all features that make a host country attractive to investors, including existing policies and recent reform initiatives.

The second justification is that the IPA can play a role in coordinating most activities aimed at improving the business environment in the host country. This role can range from providing assistance to potential and existing investors in their daily problems to lobbying for key policy and legal reforms. In many countries, the IPA is viewed as an interface between the private and public sectors.

quality of FDI, where quality might be measured by investments' impact in terms of job creation, exports, or technology transfers. Nonetheless, all developing countries are first and foremost interested in attracting more FDI, suggesting that the IPA performance can be evaluated on the basis of this shared goal. A full evaluation would involve careful cost-benefit analysis, which is beyond the scope of this paper.

We ask whether greater promotion effort is associated with more FDI. Of course, promotion is not the only factor that affects investors' decisions (box 2.2). Thus, we attempt to control for other factors that are widely believed to affect a foreign investor's decision.

To isolate the influence of these basic factors, we draw on the recent literature on the determinants of FDI. The main and most robust explanatory variables appear to be the quality of the investment climate and market size of the host economy. The importance of these two factors is linked with the two main motivations for FDI: investments are especially sensitive to the investment climate, because multinationals can generally choose between locations, and investments aimed at the local market are

Box 2.2 The Debate on IPAs' Effectiveness in Attracting FDI

Most economists agree that FDI flows are broadly a function of the quality of a country's business environment, as well as the existence of genuine opportunities. The neoclassical view is largely based on the premise that if governments work hard to build good investment climates, investors will automatically seek out the best investment opportunities.

Yet investment promotion proponents say that this is often not enough. They emphasize a market failure due to information or perception gaps about investment opportunities or state of the investment climate in a particular country, advocating that investment promotion efforts can actually play a role in influencing FDI decisions.

most easily attracted by large markets.[7] In our attempt to select explanatory variables, we also considered other factors, in particular infrastructure and education variables, as well as regional dummies, but those added only limited and inconsistent explanatory power.

Our empirical work is designed to understand whether investment promotion adds to the ability of the above variables to explain FDI flows. Our approach is discussed in detail in the technical appendix to this chapter, but two points are important. First, our approach is cross-sectional. It examines the relationships between promotion effort and FDI inflows at one point, specifically in the year 2001. We cannot measure changes in flows over time because we do not have the necessary data. The absence of time dimension in our analysis is, of course, restrictive, but it may be not as much as one might presume because of the stability of IPA budgets over time (box 2.3).

Box 2.3 The Stability of IPA Budgets over Three- to Five-Year Periods

Our approach examines to what extent differences in the promotion effort are associated with FDI flows across countries, adjusting for other factors. The data availability forces us to use FDI and IPA budget for the same year, but ideally one should expect a lag between these two variables. Wells and Wint (2001) suggest a lag of two to five years. In other words, the ideal test would link IPA budget for the years 1997–99 with FDI flows in 2001.

By using IPA budgets and contemporaneous FDI flows across countries, we assume that the IPA budgets have not significantly changed between 1997–99 and 2001. This assumption is reasonable for the large majority of countries included in our sample. All IPAs (expect for four) existed in 1998. Hence, we may assume that they already had access to the same sources of financing as in 2001, because most funding comes from government (and sometimes from donors), which has a relatively slow adjustment cycle in its budgetary allocation.

Second, we follow Wells and Wint (2001), who assume that the level of promotion effort is weakly exogenous. That is, the promotion effort is not contemporaneously affected by FDI flows. Of course, it is possible that FDI flows do, over the long run, affect promotion efforts. Although we cannot, in the absence of time-series analysis, prove that causality runs from promotion to investment, it seems unlikely that increases in foreign investment will typically cause an increase in the promotion effort. Our research with a relatively large number of IPAs confirms this impression. Our experience suggests that IPA budgets are determined and approved within a business plan that usually covers a three- to five-year period. They are rarely revised as a result of FDI flows, at least not in the short term. Indeed, only a few IPAs appear to record FDI inflows (approved or realized) or use monitoring and evaluation systems; they do not have the data to justify budget changes in response to variations in flows. Moreover, because the main source of IPA funding is the government, some degree of inertia is expected to be associated with public finance decisions.[8]

Key Empirical Findings

We explore the relationship between the investment promotion effort and FDI inflows in 58 countries during 2001.[9] Our sample is diversified in terms of region, level of income per capita, and the magnitude of investment promotion effort. To keep some homogeneity, we include only countries that have reported national IPAs. By doing this, we exclude countries, such as Brazil, China, India, and the United States, that have only regional agencies because it was difficult to assess their contribution to FDI flows at the national level. This omission may be important because these countries account for a substantial share of FDI worldwide.

By assuming that causality runs from promotion effort to FDI flows, we find that investment promotion plays a significant role in explaining the cross-country variations in FDI flows, along with the investment climate, as measured by the Heritage Index,[10] and the level of development in each country. It also continues to be robust when alternative definitions of FDI inflows are used. However, this positive association is found only when the promotion effort is measured by the IPA budget. When effort is measured by the level of human resources, the relationship is also positive, but not statistically significant. It is possible that the close relationship of FDI to expenditures means that promotion activities require less labor than money. Anecdotal evidence collected at the country level reveals that fixed labor costs usually account for less than one-third of an agency's total budget. The bulk of expenses is associated with buildings, promotion materials, advertisement, and promotional trips.

As detailed in the technical appendix, the estimated elasticity of a change in the IPA budget on cross-country FDI flows is equal on average to 0.25 for our sample. Thus, for each 10 percent increase in the promotion effort, the level of FDI increased by 2.5 percent. This simple and restricted correlation between the IPA budget and FDI must be interpreted with caution because there are many problems in doing such an evaluation with cross-country data—most of all, the limited number of observations and the possibility that both promotion and FDI are responding simultaneously to some third factor. The positive and significant correlation does not necessarily imply that promotion always positively affects FDI, but it makes it more difficult to argue that promotion is bad for attracting FDI. The positive correlation, in other words, restricts the range of possibilities.[11]

The finding that promotion is positively associated with higher FDI is subject to an important caveat: IPAs typically have limited responsibilities. The country's promotion effort is unlikely to be fully captured by the size of the IPA budget. The typical IPA is not the only agency responsible for attracting FDI flows in most countries. According to our survey, 52 percent of IPAs indicate the existence of other entities charged with the promotion of FDI in their country. A variety of both private (such as chambers of commerce) and public sector entities typically share the common objective. In addition, countries with large privatization programs often conduct promotional efforts through the ministries that oversee the transfer of assets into private hands. Further, promotional aspects of so-called "strategic sectors" of the economy, such as infrastructure and mining or other natural resources, are often under the control of other agencies or ministries, not the IPA. For example, 12 percent of the IPAs said that other agencies explicitly deal with promoting FDI in mining.

Size Matters for Effective Promotion

The above finding represents an average for 58 agencies worldwide. One concern is that IPA effectiveness is influenced by the wide range of the size of their annual budgets. The average budget for FDI promotion is about US$2.6 million per year, yet the median budget does not exceed US$650,000. Moreover, the average for developing countries is about US$1 million, and the median budget for that group is only US$430,500 (box 2.4).[12]

Similarly, human resources devoted to promotion vary greatly across agencies. The largest differences are observed between the agencies in industrial and developing countries. The number of

Box 2.4 IPA Budgets by Region

In 2001, two-thirds of the agencies reported an FDI promotion budget less than

- US$350,000 in Africa
- US$450,000 in Asia
- US$650,000 in Latin America and the Caribbean
- US$800,000 in Eastern Europe and Central Asia

Table 2.1 IPA Budgets by Income Level of Countries (US$)

	Low income	*Middle income*	*High income*
Average budget	548,500	1,237,000	9,382,100
Minimum budget	28,404	33,300	283,155
Maximum budget	1,488,833	5,593,000	27,300,000
Median budget	287,421	569,574	9,316,800

Source: Foreign Investment Advisory Service (FIAS) survey (2002).

staff is correlated with the level of income in the country. A typical IPA in a developing country has about 10 permanent professional staff members. About one-third of the agencies in developing countries have fewer than 5 professionals, but some report several dozen people. In contrast, the average size of IPA professional staff in high-income countries is 30, though a few do not have more than a dozen professionals.

We find that the association of increases in promotion effort with FDI flows varies depending on the level of expenditures by the IPA.[13] We observe that small increases for very low levels of spending have little impact on investment. There is an intermediate level of budget at which the IPA effectiveness gradually increases. Finally, above a maximum level, any increase in the promotion effort is not significantly correlated with an increase in FDI.

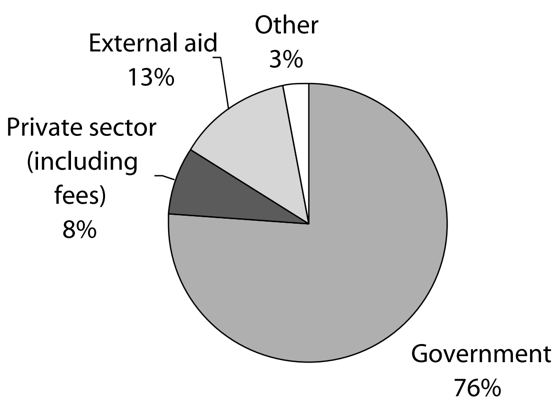
Although the above results should be interpreted with caution, for the reasons mentioned earlier, they suggest that size does matter. Small agencies are not really effective at attracting FDI. Up to a maximum budget of about US$11 million, increasing returns do exist in promotion activities. Presumably, the existence of a threshold reflects the considerable fixed costs associated with numerous activities, such as advertising and image building. This is easy to understand: An advertising campaign in an international newspaper can cost several thousand dollars; promotional trips and participation in fairs can be equally expensive, as is responding to the needs of potential investors when they visit the country. When an IPA spends less than US$64,000, it is unlikely that it can achieve more than paying a few staff and conducting limited and discrete activities.

Still, agencies that are too big have their own problems. There is a maximum level of resources beyond which there are decreasing economies of scale, even though this limit appears to be out of reach of most agencies. The existence of decreasing marginal returns can also be explained in the light of the analytical arguments used to justify the creation of IPAs. Beyond a certain limit, it is unlikely that the agency can contribute more to resolving the information and coordination issues that had justified its creation.

The important message from the above finding is that to be effective, a promotion effort requires a minimal level of financial commitment. The IPA budget needs to be beyond a certain level to exploit the increasing returns associated with most promotion activities.

For most IPAs, the bulk of financial commitment has to come from governments. They are by far the dominant source of funding, accounting for more than 75 percent of total budget for all IPAs (see figure 2.1). Among developing countries, government

Figure 2.1 Sources of Funding, Percentage of Total IPA Budget



Source: FIAS Survey (2002).

contribution represents more than 80 percent of the IPA funding. External aid was a distant second as a source of funding for IPAs, but only for a few and generally only for the start-up years (and phased out after a few years).[14] Although private sector contributions can be obtained in a variety of ways,[15] the survey findings confirm how difficult they are to come by. Only a few agencies in Latin America have managed to collect meaningful amounts in this way. The potential for private funding is limited because most IPA activities are directed to a large number of investors, without precise targeting, who do not always perceive direct benefit from the IPA's activities. Information and coordination activities are most certainly the responsibility of the government because they produce benefits to the economy that go beyond the agency and individual firms. Moreover, income generation through charging fees for specific services has hardly ever been successful, and it does not seem to present an attractive and workable option for most promotion agencies.[16]

Technical Appendix

There has been no analytical framework or model aimed at explaining the IPA behavior. In the absence of such a model, we adopt a simple approach based on the assumption that governments strive to maximize the level of FDI inflows and at the same time minimize resources allocated to the promotion effort.

One approach to understanding IPA behavior is to assume that it reflects the actions of a set of decisionmakers (for example, a board). In doing so, we adapt the conceptual approach defined by Heller (1975) in his seminal paper.[17] We assume that they maximize utility, taking into account uses of public resources required to finance the promotion effort (PE) with the objective to attract FDI. In any period, we assume the utility function of the IPA is defined as

$$(1) \qquad U = a_0 + a_1\,(FDI - FDI^*) - a_2/2(FDI - FDI^*)^2 - a_3\,(PE - PE^*) + a_4/2(PE - PE^*)^2$$

with $a_i > 0$.

This functional form ensures diminishing marginal utility for any increase in *FDI* and increasing marginal (dis)utility for *PE*, because these variables rise to a level determined by their target levels (defined with the symbol *). It reflects a compromise between the need for an estimable functional form with desirable utility function properties. The target variables are assumed to be determined by the following relationships:

$$(2) \qquad FDI^* = fEV$$

$$(3) \qquad PE^* = 0$$

The target FDI^* is set in the context of the literature on FDI determinants that assumes that long-term FDI flows are defined by a series of structural variables such as the level of economic development and the quality of the investment climate in each country. This set of external variables is defined by *EV*.

In the long-run, for simplicity, equation (3) assumes that the promotion target is equal to 0. This target supposes that investment promotion is only useful on a temporary basis, which is consistent with the analytical arguments used to justify the creation of a promotion agency. Next, we capture the temporary influence of investment promotion on the level of FDI flows by

$$FDI = sPE \text{ with } s > 0 \tag{4}$$

Maximizing the utility function defined in equation (1) with respect to *FDI* and *PE* and subject to constraint (4) yields the following equation:

$$FDI = b_0 + b_1 PE + b_2 EV \tag{5}$$

where $b_0 = (a_1 - a_3)/a_2$; $b_1 = a_4/a_2$; $b_2 = f$.

From equation (5), we define b_1 as a measure of *IPA effectiveness.* Because our model will be estimated in logarithmic form, the value of b_1 describes the elasticity of the investment promotion effort and FDI inflows. The main feature of equation (5) is that IPA effectiveness is measured by taking into account the influence of external variables and IPA characteristics. Such influence has to be considered because an increase in FDI flows can occur independently of a greater promotion effort, for example, through an improvement in macroeconomic stability, and a consequent positive relationship observed between the promotion effort and FDI may only be spurious.

The selection of the dependant variable should in principle be straightforward. However, because our interest lies in quantifying how changes in the investment promotion effort influence FDI inflows, we must be careful in our selection of candidate definitions of investment promotion effort and FDI inflows. For example, as discussed in chapter 2, most agencies do not report having the main responsibility for privatization or foreign investments in the mining sector. For this reason, we are interested in using a proxy for FDI that will allow us to best capture IPA effectiveness. Hence, we retain three alternative definitions of FDI inflows in our empirical exercise:

- Total gross FDI inflows as defined in countries' capital accounts: This proxy presents the main advantage to be based on a homogenous definition of FDI across countries. It is also available for all the countries included in our sample. However, it may imperfectly capture the role of the IPAs because a large fraction of those flows enter into sectors that are generally not under the direct control of these agencies.[18]
- FDI inflows adjusted for mergers and acquisitions (M&A): The idea is to capture more accurately the FDI flows that are under the direct control of most IPAs. Because a large fraction of foreign investment associated with M&A is the result of privatization and investments in strategic sectors that are not typically controlled by the IPAs, we adjusted our first proxy by subtracting the value of the M&A in each country.
- Approved FDI projects: This variable should in principle only account for the FDI projects under the direct control of the agency. This proxy also minimizes the time lag between the promotion effort and its expected impact because it captures the approval and not the realization of the project.

The first two proxies were obtained from the United Nations Conference on Trade and Development's (UNCTAD) database because it included more developing countries than the International Monetary Fund–World Bank database. Unfortunately, we could not use the last variable because of serious measurement problems. The first problem is that only a limited number of agencies have reported their number of approved projects, reducing our sample from 59 to 21 countries. The set of observations is therefore extremely small. The second problem is our low level of confidence in this figure provided to us by the agencies. It appears alternative definitions of approved projects are used across agencies.

The promotion effort is measured by the budget of each agency converted into U.S. dollars. The cost of certain promotional activities—mostly image building and investment generation—can be comparable independent of the IPA location (for example, the cost of an advertisement in an international newspaper would in principle be the same for Ethiopia and Germany), but some expenses can vary greatly across countries. For these reasons, we also measure the promotion effort by the number of professional staff dedicated to investment promotion in each agency. This proxy does not vary with the exchange rate and accounts for different purchasing value across countries. However, it makes the strong assumption that labor intensity determines the entire promotion effort.

To capture the external variables, we tested three alternative indicators of the local market size: gross domestic product (GDP), population, and income per capita. The level of income per capita generated the most robust results, hence we retained this variable. Similarly, we tested several indicators of the quality of the investment climate as extracted from the international business community literature (World Economic Forum, Heritage Foundation, Institute of Management and Development, and so on). After numerous tests, we selected the Heritage Index because it had added the highest explanatory power to our model.[19]

We used the ordinary least squares (OLS) technique to estimate the basic FDI equation.[20] In doing this, we follow Wells and Wint (2001), who assume that the IPA budget is weakly exogenous in the sense that it is not contemporaneously affected by FDI flows, although there is the possibility of lagged feedback over the longer term. Although we cannot, in the absence of time-series analysis, prove that causality runs from promotion to investment, it seems unlikely that increases in foreign investment will typically cause an increase in the promotion effort. We nonetheless attempted to estimate simultaneously a two-stage least squares (TSLS) model, treating IPA budget endogenously. Unfortunately, we were unable to adequately use TSLS to deal with the causal impact of FDI on the promotion effort because we failed to identify a list of good instruments for the IPA budget. Some external variables offered limited explanatory power (size of country, income level, and quality of investment climate), but neither the internal IPA characteristics nor the level of FDI inflows was statistically significant.

We tested equation (5) for a sample of 58 countries, as explained in the main text. Our empirical applications explore only the contemporaneous relationship between the promotion effort and FDI because the data were available only for the year 2001. By doing this, we do not necessarily assume that promotion has an immediate effect on overall FDI flows because we use cross-country analysis rather than time-series analysis. Our results would be significantly biased only if there had been large variations in the promotion effort in a significant number of countries over the last few years.[21] Fortunately, it appears that variations in the promotion effort across countries reported for the year 2001 are not significantly different from those that existed in the late 1990s.

Our main empirical results are summarized in table 2.2. Overall, the explanatory power of the regressions is relatively high, in spite of the limited number of explanatory variables. The chief finding, as explained in the main text, consists of the positive and significant elasticity coefficient associated with the IPA budget. This result is robust to the inclusion of other explanatory variables, regardless of the definition of FDI flows.

Table 2.2 Estimated Elasticity Coefficients[a,b,c]

	FDI		*FDI (adjusted for M&A)*	
IPA budget	0.25		0.31	
	(2.41)		(3.33)	
IPA staff		0.26		0.20
		(1.56)		(1.14)
Investment climate	–1.62	–1.64	–1.78	–1.90
(Heritage)	(–4.09)	(–3.80)	(–4.15)	(–4.12)
GDP per capita	0.57	0.73	0.42	0.49
	(2.48)	(3.10)	(1.67)	(2.11)
Observations	58	49	51	43
AdjR^2	0.682	0.683	0.696	0.681

Note: t statistics in parentheses.

a. All variables are in logs except for the Heritage Index.

b. The constant term is omitted.

c. Numerous other external variables were tested in the regressions, including GDP, regional dummies, and other investment climate indicators. In general, the results were robust independently of the inclusion or exclusion of these variables.

3

The Business Environment Matters

The positive association of promotion efforts on investment masks large differences across countries. So far, we have ignored the environment in which the IPA operates. The environment varies considerably across the countries included in our sample, from Ethiopia to Singapore, China to Ireland, Senegal, and the Dominican Republic. We find that that the quality of investment climate and the level of development strongly influence the IPA's effectiveness. This finding has important policy implications.

The Role of the Country's Environment

One might expect that investment promotion is more effective in a good rather than a poor policy environment. It is easier to convince potential investors to come to an attractive country. The agency has to convey the right information to potential investors and thus acts as a facilitator or intermediary in this process. However, in such a context, it could be argued that the agency is redundant. Most investors are well aware of opportunities in their field or industries, and they do not really need to contact (or be contacted by) an IPA. Nowadays, information flows rapidly across continents. At the extreme, for many firms, investing abroad is virtually a mouse click away.

The effect of a poor investment climate on the effectiveness of promotion is difficult to determine a priori. It is possible that a greater promotion effort is needed in a bad environment. For example, it is not uncommon to hear that few investors are interested in Africa because they are poorly informed or receive only negative news from the international media. Promotion can raise the interest of potential investors by focusing the message on the country's assets. Notwithstanding the quality of the investment climate, it can also help investors to set up operations in the country by facilitating their administrative procedures and guiding them toward the right authorities or partners.

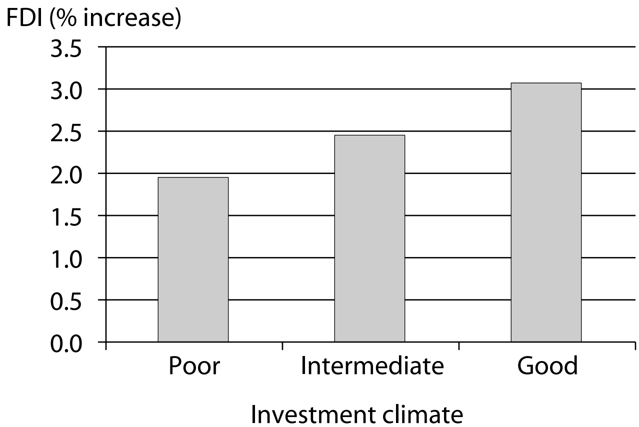
This positive view of investment promotion in a poor environment might, however, be unrealistic. Promoting a country with limited assets—for instance, a country with political and macroeconomic instability—could be highly unproductive. It could even backfire when the investors realize that their findings do not match the positive message conveyed by the promotion agency. These investors could also disseminate a negative image of the country within their own business community. Under such circumstances, policymakers might be better off focusing on improving the country's overall business climate rather than engaging in expensive promotion campaigns.

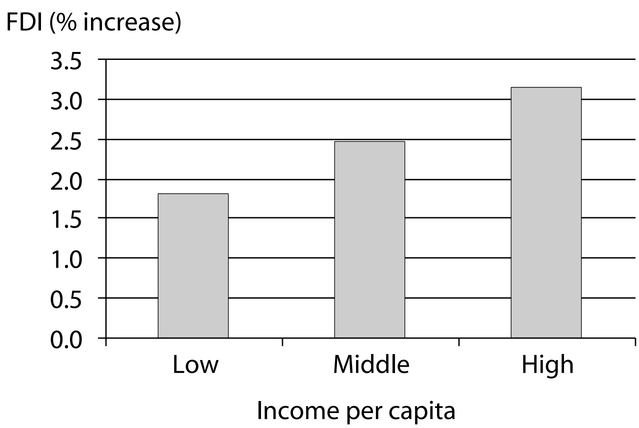
Empirical Results

Our empirical analysis clearly confirms that the quality of the investment climate and the level of development have a significant effect on IPA performance: the better the investment climate, the greater IPA effectiveness. Similarly, the higher the level of development, the more effective an IPA is. The technical appendix to this chapter provides fuller details on the estimated elasticity coefficients associated with these two features of the country's environment.

These two results can be illustrated by comparing the effectiveness of the 58 agencies included in our sample. We separate this sample by considering the agencies operating in a relatively poor, intermediate, or good investment climate.[22] We proceed with the same separation for the level of development: low, middle, and high income per capita. Figure 3.1 illustrates the consequences of a 10 percent increase in the IPA budget on the FDI

Figure 3.1 The Better the Country's Environment, the Higher the Impact of Promotion on FDI





inflows of countries, classified by the quality of their investment climates and their income levels.

The first diagram shows that an increase in IPA budget is positively associated with FDI flows. Furthermore, this effect is magnified in a good rather than a poor investment climate. Similar large differences in the impact of the promotion effort are also depicted as a function of the level of the development of the country where the IPA is located.

The above results confirm that it is easier to promote a good rather than a bad product. Investment promotion appears to be most useful in a country with an attractive business environment. When the investment climate is poor, attention has to be given to improving fundamentals, otherwise substantial—perhaps excessive—resources have to be spent on convincing potential investors. Of course, IPAs generally recognize that promotion activities by themselves are not sufficient to attract investors to the country.

Lessons for Policymakers

A practical implication is that poor countries or those with a relatively bad investment climate should focus on improving their investment climate rather than spending on promotion. Not only is promotion much less effective, but improving the investment climate will also lead to greater benefits because of two cumulative effects. Such an improvement will attract greater FDI inflows, as identified in the chapter 2, and it will also enhance the IPA effectiveness, which in turn will lead to higher FDI. This double effect should be taken into account by policymakers at times when they define options for attracting more (foreign) investment and enhancing the role of the private sector in their economy.

However, the above discussion needs to be qualified because it suggests that policymakers have to choose between investment promotion and improving the country's business environment.

In reality, these two actions are not alternatives. Through its activities, the IPA can contribute to the government's effort to improve the investment climate. We will see in chapter 4 that an important IPA function consists of supporting the reforms aimed at enhancing private sector development—the so-called policy advocacy function. Most agencies are well placed to support this effort by their institutional positioning between the public and private sectors and their contacts with both investors and policy-makers.

Technical Appendix

We explore empirically the influence of the business environment on IPA effectiveness by two potential channels. First, we attempt to identify thresholds in the quality of the investment climate (as measured by the Heritage Foundation Index) and in the level of development that would lead to significant differences in the IPA effectiveness. This approach is based on the belief that above or below specific values, the role and performance of the promotion agency differ. It assumes a nonlinear relationship between the environment and IPA effectiveness. The second channel explores the possibility of a linear relationship between the environment and the IPA effectiveness.

We illustrate our approach in the equations (2)–(4) presented below with only one of our external variables—the quality of the investment climate. To search for threshold values in the investment climate, we divide our sample of countries into two groups using multiplicative dummy variables, the first with poor investment climates and the second with good investment climates[23]:

$$(2) \qquad FDI_i = b_0 + b_{11}\ PE_i{*}DUM1 + b_{12}\ PE_i{*}DUM2 + b_2\ EV_i$$

where $DUM1$ is a dummy variable that takes the value 1 for the countries with poor investment climates, and $DUM2$ is a second dummy variable that takes the value 1 for the countries with good investment climates. If the elasticity coefficients associated with the promotion effort are significantly different between these two subsamples (b_{11} is not equal to b_{12}), this would indicate that IPA effectiveness varies depending on threshold values in the investment climate.

An extension of the methodology consists of testing the existence of a linear relationship between the quality of the investment climate and the IPA effectiveness.[24]

We start by estimating a modified version of equation (1) defined in the technical appendix of chapter 2 and adding an interaction term between the promotion effort and the investment climate:

$$(3) \qquad FDI = b_0 + b_1\ PE_i + b_2\ IC_i + b_3\ (PE_i * IC_i)$$

where *IC* is defined as the log of the investment climate indicator used. Taking the derivative of the FDI inflows with respect to the promotion effort, we can derive the IPA effectiveness as equal to

$$(4) \qquad dFDI_i/dPE_i = b_1 + b_3\, IC_i$$

This interaction term allows us to capture the effect of the quality of the investment climate on an IPA's ability to attract FDI.

The two approaches described above were tested empirically for a set of 58 countries, but only the second one led to significant results. By applying equation (4), we found that the IPA effectiveness is an increasing and linear function of the quality of the investment climate, as well as the level of development measured by the gross national income (table 3.1).

Table 3.1 The Relationship between IPA Effectiveness (*dFDI/dPE*) and External Variables

$$dFDI/dPE = \underset{(4.59)}{0.552} - \underset{(-4.31)}{0.289}\ \text{investment climate}$$

$$dFDI/dPE = \underset{(-0.56)}{-0.110} + \underset{(2.79)}{0.042}\ \text{gross national income per capita}$$

Note: All variables are expressed in log. Recall that our investment climate variable is the Heritage Foundation Index, in which an improvement in the investment climate is captured by a decline in the indicator.

To illustrate the influence of the above results, it is useful to show the range of values in IPA effectiveness that we obtain for the countries included in our sample. For example, we show in table 3.2 that for the IPA in the country with the worst investment climate,[25] an increase in its promotion effort produces a marginal increase in FDI flows two times lower than the IPA established in the country with the best investment climate (an elasticity coefficient of 0.l6 versus 0.35). Similar large differences in the impact of the promotion effort are also depicted on a function of the level of the development of the country where the IPA is located. The maximum and minimum elasticity coefficients are reported below for each of two external factors.

Table 3.2 IPA Effectiveness for Our Sample of Countries

	Minimum elasticity	*Maximum elasticity*
Investment climate	0.16 (worst)	0.35 (best)
Gross national income per capita	0.15 (lowest)	0.32 (highest)

4

The Functions of Investment Promotion Agencies and Their Effectiveness

What do IPAs do? We know from visiting IPAs that they perform a series of activities, from advertising and providing assistance to investors for obtaining visas and permits, to contacting potential investors and advocating policy reforms. Wells and Wint (2001) grouped these activities into four functional categories: image building, investment generation, services for potential investors, and policy advocacy (box 4.1).[26]

The purpose of this chapter is to examine to what extent IPA effectiveness is influenced by the weight of each of these functions in their budgets.

Overall Ranking by Function

As a starting point, we look at what functions IPAs actually carry out. On average, IPAs tend to devote the largest amount of financial resources to investment generation (33 percent of total expenses), followed by investor serves (32 percent), and image

Box 4.1 Investment Promotion Functions

Image Building

- Advertising in general financial media.
- Participating in investment exhibitions.
- Advertising in industry- or sector-specific media.
- Conducting general investment missions from source country to host country or from host country to source country.
- Conducting general information seminars on investment opportunities.

Investment Generation

- Engaging in direct mail or telemarketing campaigns.
- Conducting industry- or sector-specific investment missions from source country to host country or vice versa.
- Conducting industry- or sector-specific information seminars.
- Engaging in firm-specific research followed by sales presentations.

Investor Services

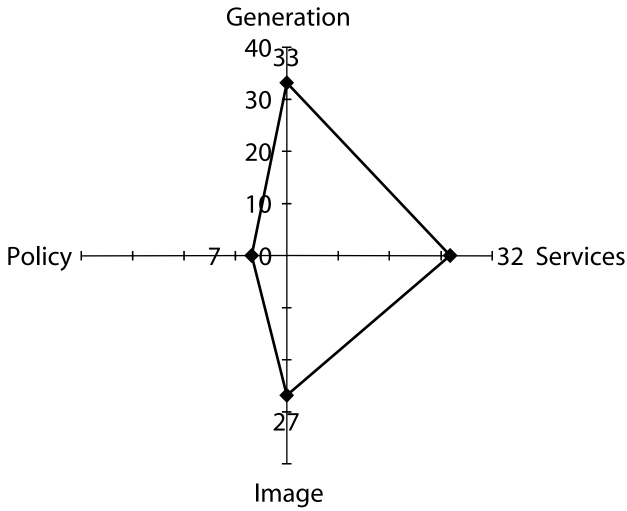
- Providing investment counseling services.
- Expediting the processing of applications and permits.
- Providing postinvestment services.

Policy Advocacy

- Participating in policy task forces.
- Developing lobbying activities.
- Drafting laws or policy recommendations.
- Reporting investors' perceptions.

building (27 percent). Policy advocacy tends to receive the smallest expenditures, amounting to no more than 7 percent on average. This ranking reflects, at least partially, the fact that some functions are simply more costly than others; still, we suspect that the allocation of resources is not optimal.

Figure 4.1 IPA's Main Functions, Average Values in Percent of Total Budget



Source: FIAS Survey (2002).

To address the appropriateness of IPA budgetary allocation, we look at how each of these functions contributes to the effectiveness of IPAs. We follow the same methodology described in chapter 2, except that we break IPA spending into its four components to detect their individual influence on FDI inflows. The estimated elasticity coefficients are presented in table 4.1 (see technical appendix for details).

Policy advocacy appears to have the strongest association with FDI inflows, followed by image building, investor services, and investment generation. This ranking shows that policy advocacy is the most associated with cross-country variation in FDI flows, and investment generation is the least associated. However, there does not appear to be a significant difference between image building and investor services, both of which appear equally associated with FDI and not far behind policy advocacy.

These estimated results represent an average for all IPAs; they do not account for the characteristics of each country in

Table 4.1 Elasticity of FDI Flows to Variation in IPA Spending by Function

Function	*Elasticity coefficients*
Policy advocacy	0.30
Image building	0.25
Investor services, facilitation	0.24
Investment generation	0.18[a]

a. All coefficients are statistically significant at 5 percent, except investment generation, which is at the 10 percent level.

which the IPA is located. A closer look at the data shows that there are wide variations among countries in IPAs' actual activities.[27] For example, it can be argued that to be effective, image-building activities should be pursued only if the image of a country is actually worse than the real conditions on the ground, and the policy advocacy function is best performed when important improvements need to take place in the domestic investment climate. Along these lines, we explored whether the effects associated with each function vary according to each country's environment, but we were unable to depict any significant relationships.[28]

A Closer Look at Each Function

The empirical results suggest that too little emphasis is being placed on policy advocacy and too much on investment generation in the budgetary allocation of the average IPA. Policy advocacy activities, such as participating in policy task forces and collecting information on investor perceptions, are effective for improving the investment climate—which in turn contributes to enhancing IPA effectiveness. Investment generation activities are expensive because they require highly specialized staff (with sufficient knowledge of the targeted sectors or companies) and travel expenses—and they produce uncertain results, especially when the overall investment climate is substandard.

Policy Advocacy

Policy advocacy appears to be the IPA function that is the most closely associated with FDI flows. This finding is consistent with our previous result that IPA effectiveness is positively correlated with the quality of the investment climate. Greater emphasis on policy advocacy should contribute to improving the investment climate, which in turn would lead to higher FDI inflows.

Most IPAs are in a strategic position to carry out policy advocacy activities because of their interface between the private and the public sector. The participation of the private sector allows the IPA to build a relationship with private firms that can help it identify the real problems that investors in the country encounter. Without private sector participation, promotion agencies can deal with such matters only from a distance because they are not able to describe problems in the kinds of specific terms that make it possible for government agencies to take the actions needed to solve them. With its government's participation, the IPA can weigh the importance to the national economy of what private investors consider to be barriers to investment. Similarly, government participation gives the agency the potential of easy access to parliaments and the ministries and agencies that are able to remove barriers that should be lifted.

Yet this function is the least favored by IPAs around the world, at least in terms of budget allocation. Of course, this comparison between functions is biased because of their cost differences. At this stage, we do not have a clear explanation for the relatively marginal spending on policy advocacy by most IPAs. For an agency's manager, other functions might seem more appealing because they are frequently associated with travel and meetings with foreign businesspeople. It is also possible that the policy reform mandate exceeds the agency's capacity and is perceived as more appropriate or effective under the auspices of the ministry of economy or other government body. Last but not least, the recognition of this function in terms of IPA effectiveness is relatively new. For example, Wells and Wint (2001) did not recognize this function in the first edition of their book on promotion in 1990[29] but they emphasized it in their 2001 revision. Similarly, many experts have underestimated the role of policy advocacy when providing advice to IPAs in developing countries because they did not experience the same urgency in their country of origin. Irish or Welsh experts, for example, may not emphasize this function elsewhere because their home countries have a relatively good investment environment.

The good news is that there is some awareness of the importance of this function in the countries with a relatively poor investment climate. Apparently, these countries have tended to allocate proportionally more financial resources toward this activity.[30] By allocating resources to the improvement of the climate for foreign investors, in most cases the agency adds benefits to local investors. Usually, what is good for foreign investment, in terms of investment climate, is equally good for the local investor. Because domestic investors also benefit from the efforts of the promotion agency to improve the climate for foreign investment, this can help the agency to deal with criticism that foreign investors get special attention.

Although the amount of money dedicated to this function may be small, virtually every agency reported undertaking some form of policy advocacy. Participation in government-led task forces seems to be the preferred channel: 80 percent of IPAs surveyed said they use this method to improve the investment climate. Next, IPAs count on holding meetings and other interactions with the private sector to receive feedback on issues in the investment climate. About 60 percent of the agencies said they undertake investor perception surveys concerning the domestic investment climate, and most of them repeat the survey exercise annually.

Who leads the policy advocacy activities? The general manager or senior managers are by far the key people handling these issues. In about one-third of the countries, members of the agency's board or committee get involved, as well.

Image Building

Image-building activities absorb about one-fourth on average of IPAs' total expenditures. This aspect of marketing a country's investment potential involves a range of activities that can be classified into three main categories: advertising, production of promotional material, and participation in events such as fairs and conferences.

Participation in public events (seminars, conferences, and so on) and the production of promotional material consume by far the most resources. This is particularly the case for developing countries, which spend 16 percent of total budget on the former and 14 percent on the latter. Agencies report on average more than 2,550 information packages distributed to foreign investors per year over the past three years.[31] Further, the average number of press releases and briefings is 29 per year.

Agencies tend to spend 10 percent of their total budget on advertising. This large share is explained by the high cost of international advertisement. On average, agencies place 9 advertisements in international media per year to promote FDI. In the case of advertisements in domestic media, however, developing countries are more active, reporting an annual average of 28 advertisements per year, and industrial countries' activity in this area is negligible.

We used the information collected in our survey to test whether subcategories of image building have different impacts on the effectiveness of IPAs in (a) advertising in local and international media, (b) public relation activities (fairs, presentations), and (c) production and distribution of promotional material.

The only significant difference that appears for the image-building function is in spending on advertising, which does not seem to have a significant association with FDI. In contrast, expenditures on promotional material and public relations activities do matter significantly (their elasticity coefficients are close to 0.4). This finding supports the argument that IPAs generally should not engage in aggressive and expensive advertising campaigns but rather concentrate on the production and distribution of promotion materials as well as public relations activities, especially if the agency follows up the initial contacts. Not surprisingly, networking is viewed as one of the essential qualities for an IPA.

Investor Services

The core of many investment promotion efforts is the provision of services to investors. This function appears quite high on the IPA's agenda, at least in terms of budget allocation. It seems to be effective because in doing so the agency takes care of investors who made the initial effort to visit the country, but it can also motivate existing investors to reinvest their earnings into the country.

According to IPAs' budgets, there are several main activities related to investor services:

- Preinvestment activities absorb about 15 percent of an IPA's budget. Agencies reported that on average they provide basic information to about 290 potential investors per year (box 4.2). Of this figure, they provide assistance-arranging missions for roughly one-third.
- Assisting investors during project implementation[32] (for example, assistance with business or tax registration, sectoral licensing, land, construction, and utilities) is usually offered by agencies that act as "one-stop shops." Accordingly, IPAs in industrial countries spend about 14 percent of their total budget on these services, but developing ones spend only 7 percent.
- Seventy percent of agencies report having developed postinvestment services, including periodic meetings with existing investors in an effort to gather information on issues they face and help them resolve problems.

Box 4.2 Preinvestment Activities

A typical IPA assisted about 90 potential foreign investors to arrange their visit to the host country. It arranged airport pickups for roughly 76 percent of those investors and would have organized meetings with government officials for about the same amount.

The average IPA organized a wrap-up meeting at the end of the mission with nearly 60 percent of foreign investors and would have followed up with 73 percent of investors after their visit.

These three kinds of assistance to investors appear to be equally associated with foreign investment (the estimated elasticity is around 0.2 for all these categories).

When they assist investors, about 40 percent of the promotion agencies report being involved in the foreign investor's registering or licensing process, with about 20 percent of these agencies having the direct power to approve investments. Moreover, more than 40 percent of IPAs report being in charge of granting some sort of fiscal or other incentives to investors, but only 14 percent said their agency had final decisionmaking power in granting them. Similarly, half of the agencies said they act as a one-stop shop for foreign investors, with an even higher proportion (80 percent) in developing countries. Yet these additional institutional powers do not seem to increase the effectiveness of the promotion agencies because we did not find any significant relationship between them and FDI inflows. As detailed in box 4.3, only a few agencies have been able to operate as successful one-stop shops.

Investment Generation

Investment generation appears to be weakly associated with cross-country variations in FDI flows. Most practitioners would

Box 4.3 One-Stop Shops

Recognizing that administrative practices pose a threat to their policy reform efforts, governments often try to find practical ways to create a more attractive business environment. An IPA, being the point of first contact and gate of entry for many investors, seems to be the most appropriate candidate to tackle these issues. During the 1980s, the concept of a one-stop shop (OSS) came into fashion as a vehicle to deal with administrative barriers and so improve the investor policy environment.

The concept of an OSS is very appealing. The basic idea is that an investor would only have to be in contact with a single entity to obtain all the necessary paperwork in one streamlined and coordinated process. The most outstanding and well-known examples include the Economic Development Board of Singapore, the Malaysian Industrial Development Authority, and the Industrial Development Authority of Ireland.

Yet these successful OSSs are exceptions rather than the rule around the world. Practically all governments that have tried to implement OSSs have encountered considerable resistance by the various government agencies responsible for the administrative procedures. Most important, other ministries and agencies fear that the creation of such an OSS would result in curtailing their authority and mandate. Thus, they quickly lead to intensive turf battles within the government bureaucracy. Without the necessary political support, OSSs have proved to be more a "one more stop" because investors have to interact with one more entity in the process of implementing their projects.

(For a fuller discussion, see: Sader, F. 2003. "Do One-Stop Shops Work?" FIAS, Washington, D.C. Processed.)

agree that investment generation has the lowest return, and, especially in our sample, that includes a majority of countries with relatively poor investment climates. This finding might be explained by the high cost and high degree of expertise required to effectively carry out targeted programs. An agency needs specialists, by sectors or enterprises, and usually time and attention to convince a particular investor to locate in its country. It takes time and money to contact investors proactively and convince them to invest in the country. Therefore, it is not really surprising that investment generation activities account for an important part of agencies' expenditure because it is a relatively costly activity.

The agencies surveyed have developed targeted programs with the following general features:

- Sixty-three percent of them report using programs targeting specific countries.
- Close to 55 percent target specific firms and sectors.
- About 50 percent have developed programs focusing on expansion from existing investors.
- Forty-five percent promote joint-venture activities with domestic investment partners.

Once IPAs have targeted their specific audience, which can combine some of the approaches described above, they use a variety of instruments to contact and eventually convince potential investors to become actual investors. Our findings show that of all the promotional activities, the largest percentage of budget (nearly 20 percent) goes toward contacting investors—face-to-face; by phone, mail, and telemarketing; and conducting missions abroad. In addition, many IPAs organize meetings for investors with potential local partners or actively conduct sectoral or market studies for specific groups of investors. This activity appears less important than proactive contacts, but it still accounts for a significant fraction of the IPAs' budget, almost 16 percent of their total resources.

A rough "back-of-the-envelope" calculation suggests that the average developing country spent approximately US$133 per investor contacted through this method, and the average industrial country spent about US$482.[33] These levels of expenditures are not explained by different ways to contact investors (the proportions of face-to-face contacts are approximately the same between developing and industrial countries) but rather by the overall level of budget associated with each agency. The IPAs in industrial countries spend more per investor contacted simply because they have higher budgets than those in the developing world. In spite of these differences in the expenditure levels, it is worth recalling that we have not been able to depict significant variations in the effectiveness of investment generation across agencies.

Table 4.2 Average Number of Investors Contacted per Year by Agency

	Total proactive contacts	*Of which face-to-face*	*Of which by telephone*	*Of which by mail or telemarketing*	*Targeted missions*
All countries	1,872	382	374	959	12
Developing countries	1,395	309	256	667	11
Industrial countries	3,955	750	904	2,289	17

Source: FIAS survey (2002).

Technical Appendix

We test how IPA effectiveness can be influenced not only by the amount of resources spent by the agency but also by how these resources are allocated across its functions or activities. To explore this question, the promotion effort is divided into its four components (image building, investment generation, investor services, and policy advocacy), and their impact on FDI flows is assessed. In other words, we disaggregate the promotion effort to obtain the following equation:

$$FDI_i = b_0 + b_{11}\, IB_i + b_{12}\, IG_i + b_{13}\, IS_i + b_{14}\, PA_i + b_2\, EV_i + b_3\, IPAC_i$$

where *IB* is defined as the effort in image building, *IG* as investment generation, *IS* as investor services, and *PA* as policy advocacy.

To test this question, we use the same methods described in the technical appendix of chapter 2. The elasticity coefficients associated with each function are summarized in table 4.1 of the main text.

5

Key Internal Characteristics of Investment Promotion Agencies and Their Roles

The conceptual framework developed by Wells and Wint (1990, revised 2001) suggests that an IPA's effectiveness is influenced by its institutional structure and reporting mechanisms. Our empirical findings suggest that structure matters. The most efficient agencies share a high political visibility and relatively strong private sector participation. These influences are generally magnified through the existence of a board of directors, which includes representatives from the private sector and is chaired by the country's prime minister or president. Other IPA characteristics—such as their legal status, mandate, or sources of funding—were not identified as being important.

Main IPA Characteristics

Most advisers to IPAs argue that an agency's legal status, degree of private sector participation, or mandate influence the way the IPA does business and its ability to attract foreign investors.

We examined the main IPA characteristics suggested by Wells and Wint (2001). In particular, the survey conducted by FIAS identified a set of internal variables that capture the institutional structure of each agency:

- Age of the agency
- Legal status of IPAs (founded by law or decree)
- Institutional affiliation and linkages with government (public, semipublic, autonomous, or private body)
- Linkages with the private sector (financial contribution, frequency of meetings and inputs, degree of private sector representation on board)
- Reporting arrangements (board, government body, prime minister or president)
- Overseas offices
- Number of mandates on top of foreign investment promotion (for example, export promotion, privatization programs)
- Staff's characteristics and salary policy (civil servant, wage level compared with the private sector, bonuses and incentives).

Many IPAs share similar characteristics (see box 5.1). Most agencies are relatively young: only 25 percent of IPAs reported that they are older than 10 years and only 12 percent are more than 20 years old. Similarly, almost all IPAs were created either by law or decree. Another common feature is that almost 80 percent of the IPAs report that they are public institutions: they are sometimes integrated within a ministry or established as an autonomous agency, which provides them with an independent budget. Only 25 percent of IPAs from the developing world have overseas offices (versus 80 percent in high-income countries). The few IPAs in developing countries that have a presence abroad said they use embassy channels to promote investment instead of establishing their own offices abroad.

Box 5.1 Snapshot of a Typical IPA in a Developing Country

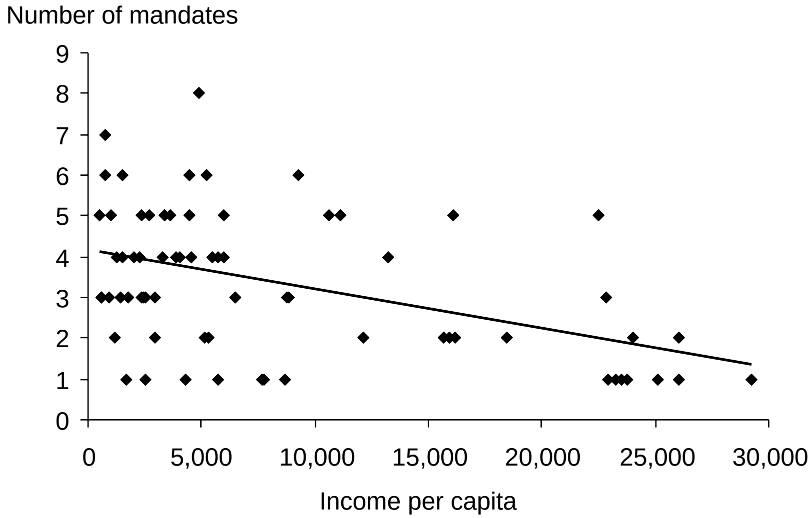
The typical IPA in a developing country is relatively young, created less than 10 years ago either by a decree or law and constituted as a public body, as part of a ministry, or as an autonomous agency. It reports to a minister or a board of directors or sometimes to both.

Most often, its mandate goes beyond the promotion of foreign investment and includes domestic investment and export promotion. Still, the IPA tends not to have the prime responsibility for privatization or for promotion of such key sectors of the economy as mining, agriculture, and special economic or industrial zones

We also observe little variation in the qualifications of IPAs' staff and their wage policies. Most report that nearly 80 percent of the employees have reached university or highest level of technical education, and almost 60 percent have had previous private sector experience. The majority of IPAs indicate that they offer bonuses and other performance-based incentives to their staff. Offering such incentives undoubtedly attracts qualified people and motivates them. This uniformity appears relatively surprising because of the public sector status of the majority of agencies.

We find more variations in the reporting mechanisms across agencies. IPAs report to a minister, a board of directors—often composed of both private and public representatives—or both. The level of political visibility varies considerably across agencies, but only 10 percent of IPAs surveyed report to a prime minister or president. Almost two-thirds of the IPAs surveyed report to a board of directors, which is usually responsible for supervising the agency's performance and defining its global strategy. In most instances, some variation of arrangement for reporting to a ministry exists in parallel. Most boards include representatives from both the private and public sectors, generally in equal numbers. Public sector participation ensures links with the government, which remains predominant in terms of strategy and fund-

Figure 5.1 Correlation between Number of Mandates and GDP per Capita



ing. However, participation of the private sector can help increase the agency's visibility and credibility. Strong private sector linkages can enhance policy dialogue on investment issues and overall governance, management, and performance of the agency. In addition, it also raises the perception of objectivity by potential investors, who tend to be fearful of biased sources of information through purely governmental agencies.

The last characteristic we examined is the number of mandates assigned to the IPAs. Agencies generally have a mandate that goes beyond foreign investment promotion. Often, they combine domestic investment promotion (54 percent of IPAs), export promotion (34 percent), or privatization (19 percent) or all three. The number of mandates assigned to IPAs appears to be inversely correlated with the income level of the country in which the agency has to operate, suggesting that agencies tend to combine their responsibilities when they face tight constraints on budgets or human resources.

Which Characteristics Really Matter?

We expect that the characteristics described above may influence the effectiveness of IPAs in attracting FDI flows through two channels. First, they can affect them independently of the level of promotion effort. For example, an agency might be consistently more effective if it receives strong political support through direct reporting links to the highest government authority in the country. Second, we explore whether these characteristics are related to the degree of promotion effort carried out by the agency. It is possible that IPA effectiveness is enhanced when the agency benefits from strong political support in high places or the adoption of a focused mandate.

Although we tested all the above characteristics with alternative specifications, using both dummy variables and interactive terms associated with the IPA budget variable, only three characteristics seem to have significant effects on the effectiveness of IPAs across countries (see technical appendix for detailed results):

- FDI flows are significantly lower in countries where the IPA is part of a ministry instead of an autonomous body or a joint private-public institution.
- The effectiveness of IPAs is enhanced when the agency reports to a supervisory board that includes representatives of the private sector. The higher the number of private members, the greater IPA effectiveness.[34]
- When the agency reports directly to a country's president or a prime minister and all other factors are equal, it is found to be associated with higher FDI flows.[35]

These findings suggest that the most effective IPAs benefit from visibility and from participation by the private sector through their boards or through institutional relations. These characteristics reinforce the leverage of the agency and its role.

They also indicate that including the private sector contributes to broaden the platform and help to achieve a consensus in the agency's effort to market the country abroad. Yet they should not be used to overestimate the role of the IPA. The reporting mechanism to the president or the prime minister may reflect the overall commitment of the government toward reforms. Within that context, the positive correlations reported above, although indicative, would capture this global trend in the government's effort rather than the agency's own performance.

Some IPA characteristics do not seem to influence the agency's performance. The agency's mandate, staff qualification, and number of overseas offices have no significant association with FDI flows. It is possible that these characteristics do not matter. Another possibility is that our survey has too little variation in these factors to identify their eventual impact on the effectiveness of IPAs.

The lack of influence from the number of mandates is somewhat surprising because of the belief that agencies focusing exclusively on investment promotion should be more effective than those dealing with several activities simultaneously. Although export promotion and investment promotion are indeed related,[36] these two activities are in reality quite different. They require different skills, and they involve contacts with different kinds of managers within foreign firms. Investment promotion is very similar to the business task of selling major plant and equipment. Not only will the decision affect the costs of the firm and its access to particular markets, but it also may have broad strategic implications, such as generating moves from competitors or even affecting the firm's political relations at home. The decisions to make such investments require the commitment of very high levels of management—and convincing management demands personal selling skills as well as the provision of various kinds of services. In contrast, export promotion is very similar to the business tasks of retail sales or sales of materials. They are likely to involve repeated smaller transactions, rather than one large-scale transaction, as in the case of a direct investment. Because the commitment is less and the decision is reversible, the amount of research done by the "buyer" is likely to be less than that done for a major investment decision. The different characteristics of exports and investments suggest that the two functions should be separated in two organizations.

We did not find any significant relationship between the mandate and the IPA effectiveness, suggesting that the argument might be more subtle than what is briefly summarized above. Although investment and export promotion do differ, they can be carried out effectively by one agency if the agency's structure and organization distinguish clearly between these two functions. The success of a few promotion agencies has shown that there are sufficient similarities and common goals that the two organizations should cooperate closely. Each is likely to be able to make use of material prepared by the other, for example. Cooperation might even extend to sharing of space, to save rent. The two opposite effects might explain the absence of significant empirical results.

Technical Appendix

The influence of the main IPA characteristics on the FDI flows was tested using the same approach as described in chapter 4. We used the basic FDI equation defined in the technical appendix in chapter 2 to which we add, as an explanatory variable, each IPA characteristic.

$$FDI = b_0 + b_1 PE + b_2 EV + b_3 IPA$$

FDI is defined as the flows of foreign direct investment, *PE* as the promotion effort, *EV* as a set of external variables, and *IPA* as a set of IPA characteristics. All these variables have been described in the main text.

The methodology was twofold. First, we used dummy variables and, second, an interactive term multiplied to the IPA budget. The first approach captures the possible effect of the IPA characteristics on the FDI flows independently of the promotion effort. The second approach assumes a linear relationship between the IPA budget and the IPA characteristics. These two approaches have been detailed in the technical appendix to chapter 4.

The main empirical findings are summarized in table 5.1.

Table 5.1 The Influence of IPA Characteristics on FDI Inflows

Dependant variable/explanatory variable[a]	*FDI*	*FDI*	*FDI*
Public agency dummy	–0.79		
	(–2.43)		
Number of private representatives in the IPA board[b]		0.052	
		(2.72)	
Prime minister/president dummy			0.53
			(1.80)
IPA budget	0.21	0.22	0.25
	(1.95)	(2.01)	(2.29)
Observations	56	36	55
AdjR^2	0.71	0.72	0.68

Note: t statistics in parentheses.

a. We omit reporting the results associated with the constant term, GNI per capita, and the Heritage Foundation Index that were also included in the above regressions.

b. The number of representatives ranges from one to the maximum registered in our survey.

6

Conclusion and Policy Recommendations

Our research has been the first empirical study on the effectiveness of investment promotion agencies in attracting FDI. Such agencies exist in almost all the countries around the world, but there has been no global attempt to determine whether they have been able to significantly influence the investor's decision to locate in one country rather than another.

Although our empirical approach contains several limitations, it shows that promotion is unambiguously associated with greater FDI flows, on top of the influence of factors such as the country's investment climate and market size. The first conclusion is, therefore, that establishing a promotion agency could bring some benefits in most countries around the world. Furthermore, the agency's budget needs to be big enough to carry on basic promotion activities. Presumably, promotion activities have large fixed costs, such as taking care of potential investors, traveling, and providing promotional materials. Agencies with budgets that are too small are basically unable to attract the attention of most investors. Our review of the recent international experience indicates that this financial commitment has to come principally from the government, which remains the main source of financing.

The effectiveness of IPAs needs to be qualified: it is highly dependent on the quality of the investment climate and the level of development of the country in which the agency operates. Countries with a relatively poor investment climate or low income per capita should focus on improving these factors rather than spending on promotion, especially if the IPA budget needs to reach a certain level, as argued earlier. The argument is that improving the investment climate will not only contribute directly to attracting more investment, it will also enhance the impact of promotion and, in turn, lead to additional investment.

The type of activities that IPAs carry out also has an influence on their effectiveness in attracting FDI. We find that on average IPAs should devote more resources to policy advocacy activities that contribute to the improvement of the investment climate and thus generate additional investments. These activities are not only beneficial for FDI but also for domestic investment. In contrast, investment generation or targeting, which has been privileged at least in terms of budgetary allocation by most agencies, appears as the function the least associated with cross-country variations in FDI flows. Moreover, this function is expensive and risky, especially in countries with poor investment climates.

Last but not least, a few IPA characteristics influence their capacity to attract FDI. Countries where the agencies have established reporting mechanisms to the highest level of policymakers (for example, the president or the prime minister) and have benefited from the support of the private sector have been systematically associated with more FDI. Such institutional links strengthen the government's commitment and reinforce the agency's credibility in the eyes of the business community.

Statistical Appendix

The Foreign Investment Advisory Service (FIAS), with the support of the Multilateral Investment Guarantee Agency (MIGA) and the World Association of Investment Promotion Agencies (WAIPA), conducted a survey of more than 100 investment promotion agencies around the world.

The questionnaire was developed with the active participation of former and current IPA managers and international experts. Pretesting was carried out on five IPAs in January 2002. The final questionnaire included 192 questions.

The survey was designed to gather quantitative information on the following five categories:

1. IPA institutional features (10 questions)
2. Mandate and responsibilities (16 questions)
3. Financial and human resources (37 questions)
4. Functions and activities (92 questions)
5. Performance indicators (34 questions).

Between February and May 2002, the survey instrument was sent via email or fax to 114 agencies around the world, in both developing and industrial countries. To ensure some homogeneity in the database, the sample included only national IPAs. We were able to collect responses from 75 agencies, yielding an overall response rate of 66 percent. The rate was even higher in Latin America and in Eastern and Central Europe, where it reached 86 percent and 71 percent, respectively. The number of responses was also relatively well distributed among low-income, middle-income, and high-income countries, giving us a well-diversified sample in terms of economic development and investment climates.

The responses to a selected set of questions are summarized in a series of figures and tables. For confidentiality purposes, the responses are reported for income groups rather than for individual countries. We used the World Bank's classification to define low-, lower-middle-, upper-middle-, and high-income countries.

Institutional Features

Figure 1 Age of Agency
Figure 2 Mode of Creation
Figure 3 Institutional Forms
Figure 4 Reporting Mechanism

Mandate and Responsibilities

Figure 5 Export and Investment Promotion
Figure 6 Prime Responsibility in Granting Incentives, Licenses, or Both
Figure 7 Investment Promotion and Privatization

Financial and Human Resources

Figure 8 Annual Budget per Income Group
Figure 9 Budget Allocation per Agency Function

Figure 10 Number of Professionals Employed in FDI Promotion
Figure 11 Staff Qualification

Function and Activities

Figure 12 Average Web Hits and Inquiries per Year
Figure 13 Advertisement in Domestic and Foreign Media per Year
Table 1 Investment Generation Activities (Average per Agency)
Table 2 Investor Services (Average per Agency)
Figure 14 Policy Advocacy Activities

Institutional Features

Figure 1. Age of Agency

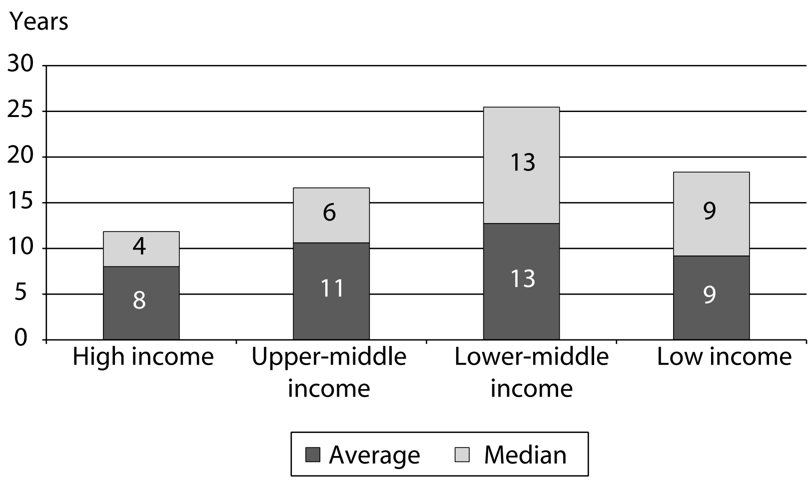


Figure 2. Mode of Creation

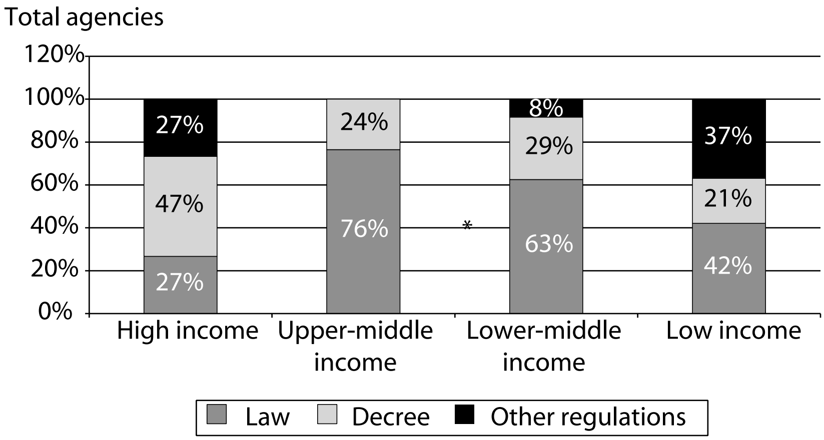


Figure 3. Institutional Forms

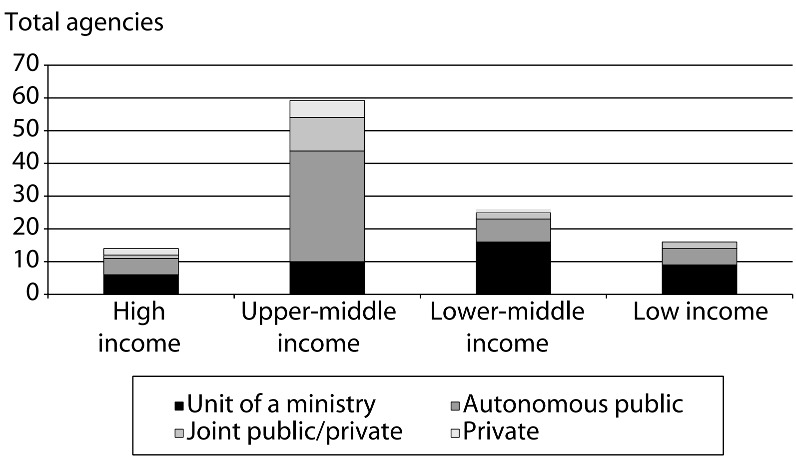
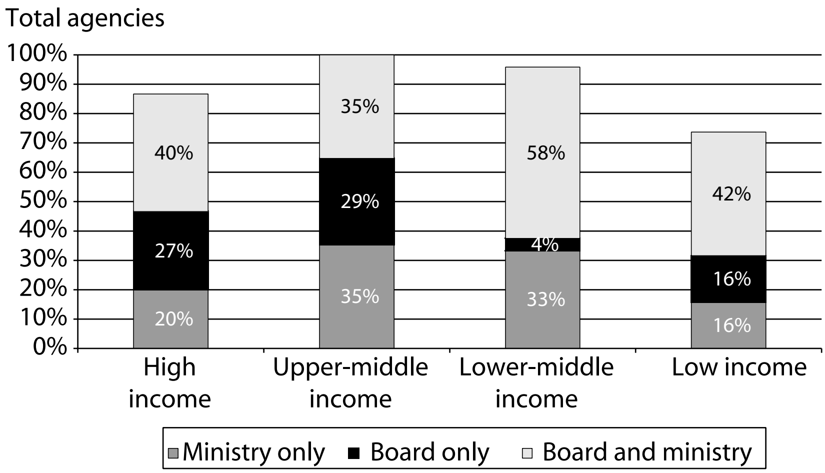


Figure 4. Reporting Mechanism



Mandate and Responsibilities

Figure 5. Export and Investment Promotion (% of Total Agencies per Income Group)

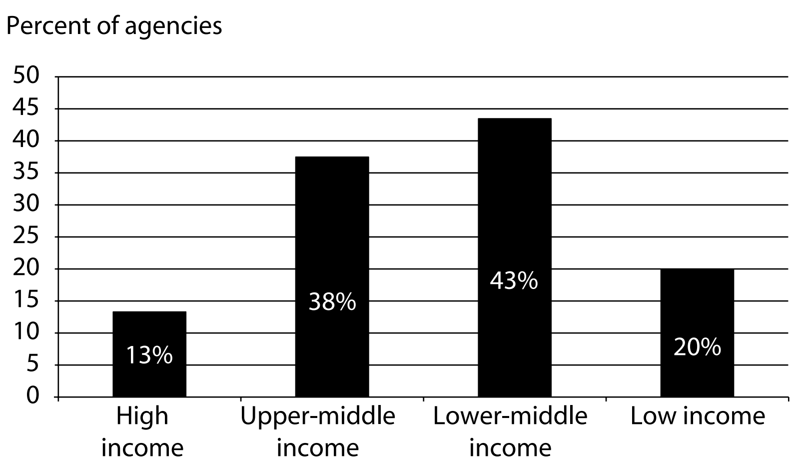


Figure 6. Prime Responsibility in Granting Investment Incentives, Licenses, or Both (% of Total Agencies per Income Group)

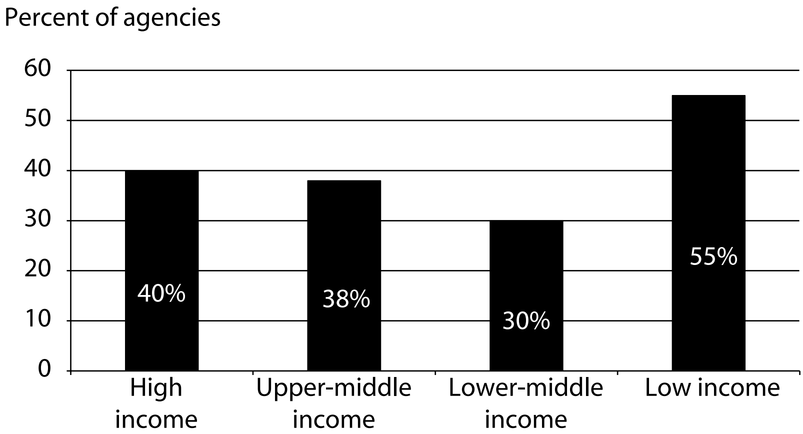
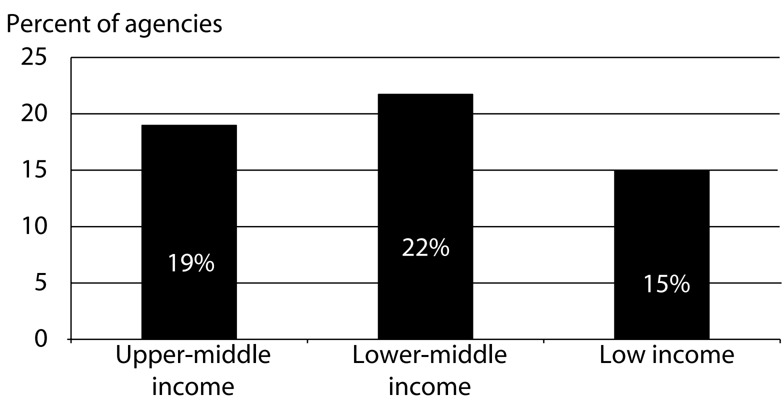


Figure 7. Investment Promotion and Privatization (% of Total Agencies per Income Group)



Note: Agencies in high-income countries did not report having any responsibility for privatization.

Financial and Human Resources

Figure 8. Annual Budget per Income Group

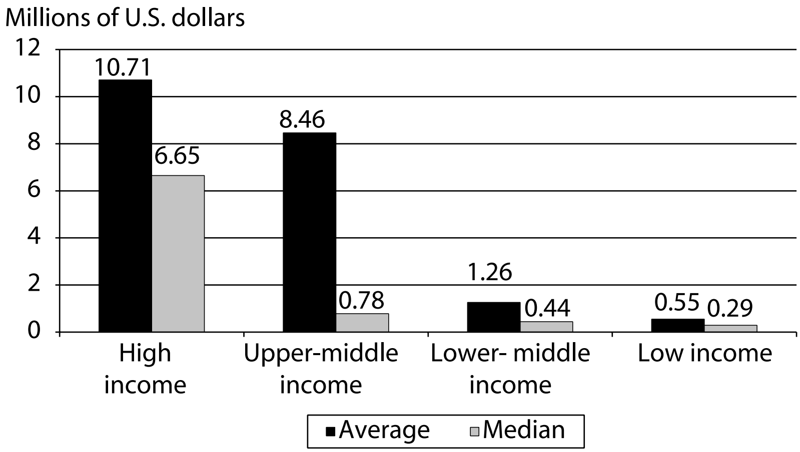


Figure 9. Budget Allocation per Agency Function

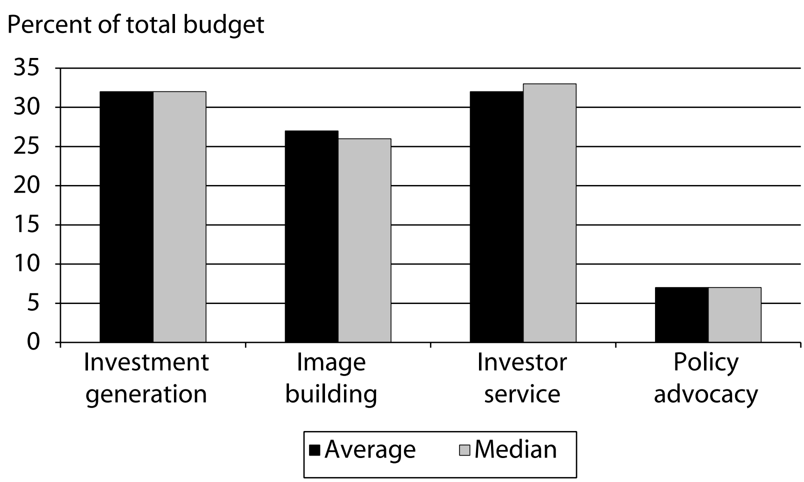


Figure 10. Number of Professionals Employed in FDI Promotion

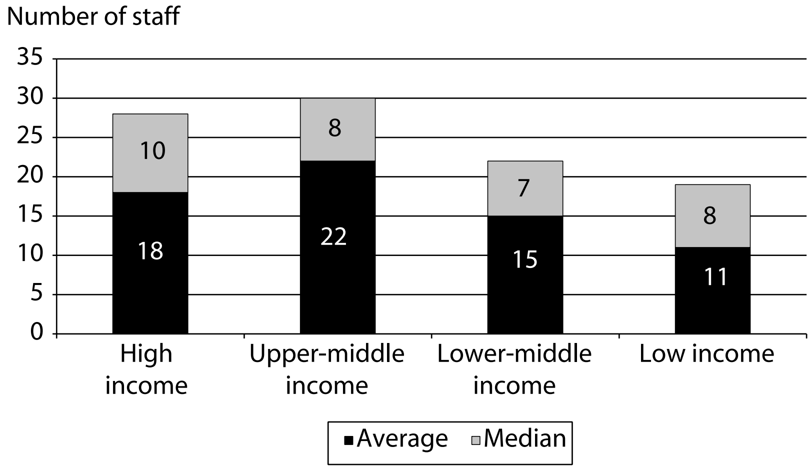
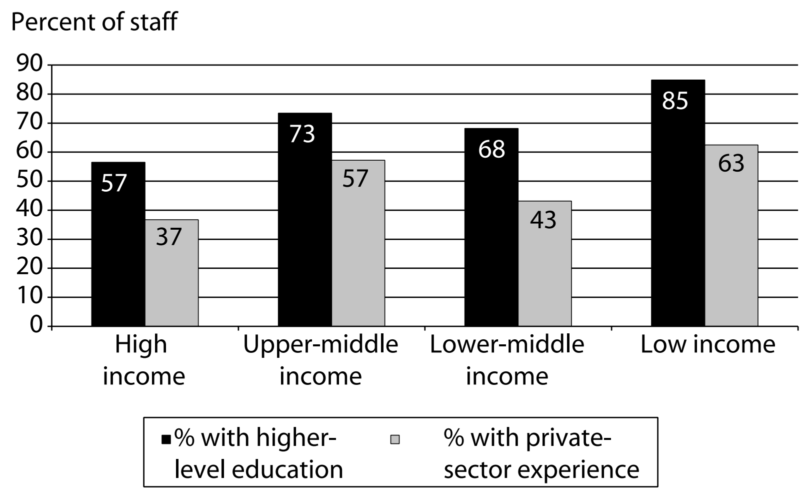


Figure 11. Staff Qualification



Function and Activities

Figure 12. Average Web Hits and Inquiries per Year

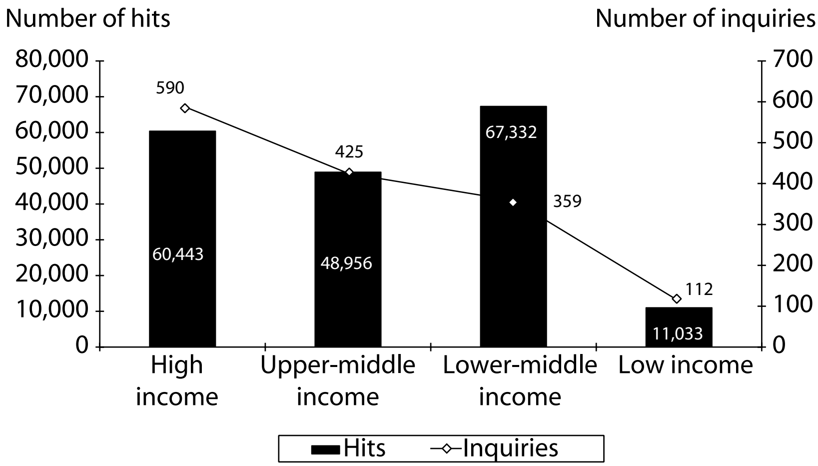


Figure 13. Advertisement in Domestic and Foreign Media per Year

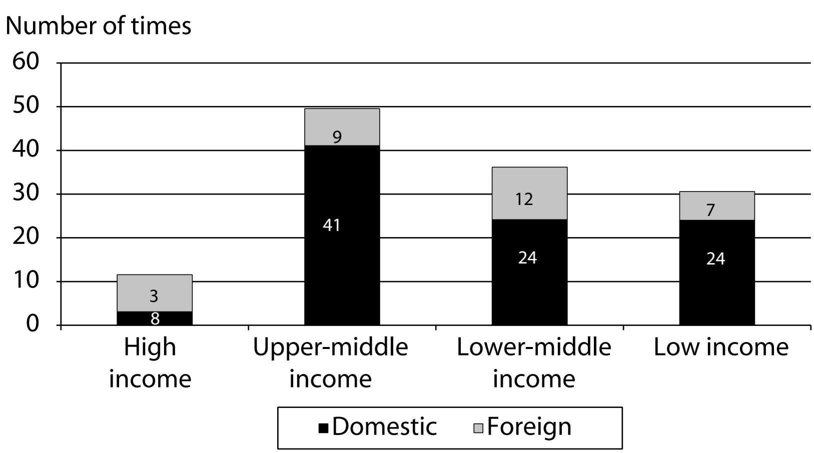


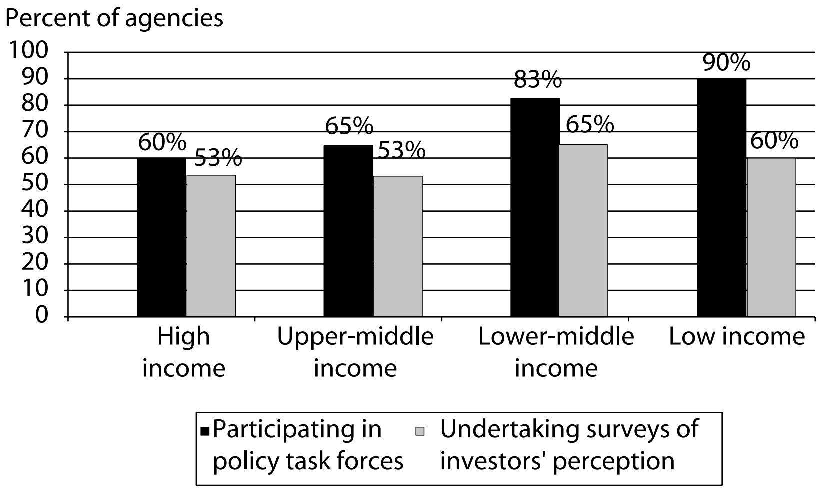
Table 1. Investment Generation Activities (Average per Agency)

	High income	*Upper-middle income*	*Lower-middle income*	*Low income*
Total number of proactive contacts	3,954	2,348	1,105	807
Face-to-face	750	249	348	328
Phone	903	195	266	303
By mail or telemarketing	2,288	636	837	582
Targeted missions	17	10	11	12

Table 2. Investor Services (Average per Agency)

	Average number of activities per agency	*% of total activities*	*% of each service category*
Total	1,409	100	
Preinvestment activities	623	44	100
Arranging visiting missions of foreign investors	92	6	15
Of which: airport pickups	63	4	10
Of which: organizing meetings with government officials	49	3	8
Of which: wrap-up meetings with foreign investors	55	4	9
Land and site location investigations and visits	46	3	7
Providing information to potential investors	255	18	41
Follow-up after investor's visits	64	5	10
Implementation activities	650	46	100
Business registration	96	7	15
Tax registration	35	2	5
Sectoral licenses	80	6	12
Land and construction approvals	37	3	6
Utilities	227	16	35
Legal advice	80	6	12
Other business assistance	94	7	15
Aftercare activities	137	10	100

Figure 14. Policy Advocacy Activities



ANNEX
FIAS-MIGA QUESTIONNAIRE

The following pages contain the questionnaire distributed during the research for this book.

FIAS/MIGA CENSUS OF INVESTMENT PROMOTION AGENCIES
February 2002

We appreciate your taking the time to answer this survey. All of the questions have been carefully considered. Responses will be treated as fully confidential.

Country:	[ ]
Agency name:	[ ]
Chief executive:	[ ]

This survey was completed by:
Please provide information on the person responsible for submitting the questionnaire or the main contact person, for follow up if necessary.

Name:	[ ]
Title:	[ ]
Telephone:	[ ]
Fax:	[ ]
Email:	[ ]

How to respond:
We suggest that you save this form as a Word document. Finished surveys should be sent as an email attachment to (deleted) by 8 March 2002. For questions please contact (deleted).

Specific instructions:
Please note that in this questionnaire "Promotion of foreign direct investment" encompasses the various activities undertaken by agencies to promote FDI, i.e., those aimed at improving a country's image (image building), those aimed at generating foreign investment directly (investment generation), those aimed at providing services to prospective and current investors (investor servicing), and those aimed at advocating policy reform (policy

advocacy). Please specify in the comments section at the end of the questionnaire if you use a different approach.

In some parts of the questionnaire, estimates of staff, costs, etc. are requested as we understand that precise figures may not be available. This applies particularly to section E on the activities of your agency: we encourage you to provide your best estimates on staff time and budget breakdown.

The period to which data should refer is specified in the relevant sections: we hope your agency has data for that period. If this is not possible, please specify the period to which your data refer.

A – INSTITUTIONAL DATA

Table 1: Basic data

1 - Name of agency	[ ]	
2 - Date of establishment	[ ]	
3 - Agency created by:	☐ Law	(please check box)
	☐ Decree	
	☐ Other (please specify) [ ]	
4 - Agency status	☐ Sub-unit of ministry	(please check box)
	☐ Autonomous public body	
	☐ Semi-autonomous agency reporting to a ministry	
	☐ Joint public-private entity	
	☐ Private	
	☐ Other (please specify) [ ]	

Table 2: To whom your agency reports

Please (1) indicate to whom your agency reports, and (2) provide the name of the ministry, board, and/or other relevant group/organization. (Please check one or more boxes.)

5 - ☐	Ministry (ies)	Please specify	[ ]
6 - ☐	Board/committee	Please specify total number of members:	[ ]
		of which: - private sector representatives	[ ]
		- public sector representatives	[ ]
		Who appoints the board/committee members:	
		☐ Minister, which one	[ ]
		☐ Other, please specify	[ ]
		Is the board/committee chaired by a minister?	Y ☐ N ☐
		From which ministry?	[ ]
		Which other ministries or government bodies are represented on the board/committee?	[ ]
		Does the agency conduct its day-to-day operations and implement personnel policies independently from the board or committee?	Y ☐ N ☐
7 -	Other reporting arrangements	Please describe [ ]	

Table 3: Structure

8 - Agency	Names of departments/divisions (For this information, you may provide a diagram of the current structure of the agency.)	[ ]
9 - Agency's regional offices in the country, if any	Number of offices	[ ]
	Number of staff employed in regional offices (full-time equivalent)	[ ]
	Percent of total agency budget (if applicable)	[ ]
10 - Agency's overseas representation, if any	In which countries	[ ]
	Percent of total agency budget	[ ]
	Is it: ☐ via your own agency's own offices	.
	number of offices (please indicate)	[ ]
	☐ via your embassies overseas	

B – MANDATE

Table 4: Areas of responsibility

AREAS OF RESPONSIBILITY	Prime responsibility	Number of staff employed (full-time equivalent)	% of budget allocated (approx.)
11 - Promotion of FDI	☐	[ ]	[ ]
12 - Promotion of domestic investment	☐	[ ]	[ ]
13 - Export promotion	☐	[ ]	[ ]
14 - Promotion of privatization	☐	[ ]	[ ]
15 - Foreign investor registration/licensing	☐	[ ]	[ ]
16 - Granting fiscal or other incentives	☐	[ ]	[ ]
17 - Management of industrial estates or free trade zones	☐	[ ]	[ ]
18 - Financial assistance to local entrepreneurs	☐	[ ]	[ ]
19 - Technical assistance/training to local entrepreneurs	☐	[ ]	[ ]
20 - Other (promotion of tourism, outward investment, SMEs, etc.)	☐		
Please specify		[ ]	[ ]

21- Does your agency operate as a one-stop shop?[37] Y ☐ N ☐

22 - Is there any sector or region in your country for which an agency other than yours has prime FDI promotion responsibilities? Y ☐ N ☐

23 - If yes, please specify (please check boxes)
mining ☐ tourism ☐ agriculture/agro-industry ☐ fisheries ☐ social sectors
export processing zones ☐ other ☐ (please specify) [ ]

24 - If your agency deals with registration/licenses of FDI, are they automatically granted? Y ☐ N ☐

25 - If not, does your agency have final decisionmaking power? Y ☐ N ☐

26 - If your agency manages fiscal and other incentives, does it have final decisionmaking power in granting them? Y ☐ N ☐

C - Agency resources and expenditures

Please provide figures in U.S. dollars. If this is not possible, please specify currency: [ ]
and applicable exchange rate against the dollar for the relevant period: [ ].

Data should refer to 2001 or latest available financial year. Please specify period: [ ]

Table 5: Overall sources of funds

SOURCE OF FUNDS	For FDI promotion functions only	If the information is not available for FDI promotion functions separately, please provide data for your agency as a whole
27 - National government	[ ]	[ ]
28 - Private sector contributions (other than fee charged for services)	[ ]	[ ]
29 - Fees for services charged to investors	[ ]	[ ]
30 - Bilateral and multilateral donors[38]	[ ]	[ ]
31 - Other (please specify)	[ ]	[ ]
32 - Total funding	[ ]	[ ]

Table 6: Total expenditures

BUDGET ITEMS	For FDI promotion functions only	If the information is not available for FDI promotion functions separately, please provide data for your agency as a whole
33 - Salaries and benefits (including bonuses)	[ ]	[ ]
34 - Other fixed costs (office rent, etc.)	[ ]	[ ]
35 - Fees paid to consultants	[ ]	[ ]
36 - Publications and other promotional materials	[ ]	[ ]
37 - Training of staff	[ ]	[ ]
38 - Travel	[ ]	[ ]
39 - Other (please specify)	[ ]	[ ]
40 - Total budget	[ ]	[ ]

Table 7: Staff

BUDGET ITEMS	For FDI promotion functions only	If the information is not available for FDI promotion functions separately, please provide data for your agency as a whole
Number of		
41- Full-time permanent staff	[ ]	[ ]
Of which:		
42 - Professional staff	[ ]	[ ]
43 - Support staff	[ ]	[ ]
44 - Temporary or part-time staff	[ ]	[ ]
45 - Consultants/agents on ongoing assignments in excess of 6 months	[ ]	[ ]
46 - Turnover of professional permanent staff per year (%)	[ ]	[ ]
47 - Status of staff (please check box)		
- Civil servants	☐	☐
- Private sector	☐	☐
- Other (please specify)	[ ]	[ ]

48 - Average salaries (please check box)		
- At par with public sector	☐	☐
- Between public and private sector levels	☐	☐
- Competitive with private sector wages	☐	☐
49 - Do you use bonuses or other performance-based incentives?	Y ☐ N ☐	Y ☐ N ☐
50 - If yes, what percentage of the salary of those eligible does this represent, on average?	[ ]	[ ]

Table 8: Staff background and qualification

	For FDI promotion functions only	If the information is not available for FDI promotion functions separately, please provide data for your agency as a whole
Out of the professional staff employed, what percentage:		
51 - Has a higher level of qualification (e.g., university or highest level of technical institute)	[ ]	[ ]
52 - Has previous private sector experience	[ ]	[ ]

Table 9: Technical tools: databases, tracking systems, website

	Computer-based	Non-computer-based
Do you have your own database:		
53 - On current foreign investors?	Y ☐ N ☐	Y ☐ N ☐
54 - On potential foreign investors?	Y ☐ N ☐	Y ☐ N ☐
55 - On available local joint venture partners?	Y ☐ N ☐	Y ☐ N ☐
56 - Other (please specify)	Y ☐ N ☐	Y ☐ N ☐
57 - Have you set up a computer-based investor tracking system?		
Do you record in a computer-based database FDI statistics on		
58 - Approvals?	Y ☐ N ☐	Y ☐ N ☐
59 - Actual or realized investment?	Y ☐ N ☐	Y ☐ N ☐
60 - Have you set up your own website?	Y ☐ N ☐	Y ☐ N ☐
61 - How many times is it updated per year?	[ ]	[ ]
62 - How many website hits do you record per month on average?	[ ]	[ ]
63 - How many web inquiries do you receive per month on average?	[ ]	[ ]

64 - Please provide an estimate of your agency's FDI promotion staff, time, and/or budget spent on the development and maintenance of the above-mentioned technical tools.

Number of staff	% of time	% of budget
[ ]	[ ]	[ ]

D – STRATEGIC PLANNING

Table 10: Strategic planning

65 - Does your agency have a FDI promotion strategy statement?	Y ☐ N ☐
66 - How often is your FDI promotion strategy revised?	[ ]
Does the strategy identify	
67 - Priority sectors?	Y ☐ N ☐
68 - Priority source countries/regions?	Y ☐ N ☐
69 - Other priorities (please specify)	Y ☐ N ☐
70 - Does your agency conduct strategic studies of your country's competitive advantages?	Y ☐ N ☐
71 - Do you prepare annual business plans?	Y ☐ N ☐
72 - Is the plan approved by your board or committee?	Y ☐ N ☐
73 - Do you specify investment targets or other performance indicators to be achieved in your annual plan?	Y ☐ N ☐
- If yes, please specify	[ ]

E – FUNCTIONS AND ACTIVITIES

Please note that (1) the promotion functions and activities listed below refer to those aimed at foreign investors, and (2) unless otherwise specified, the information provided should refer to the **average for the last three years** (1999–2001), if possible. If not, please specify period: [ ].

In the tables below, (1) please indicate how often per year your agency engages in the specified activities, and (2) if possible, provide an **estimate of the percentage of your agency's total FDI promotion time or budget** spent on such activities.

E.1 Image building

Table 11: Image building activities

ACTIVITY	How many times per year
Advertising in	
74 - Domestic media	[ ]
75 - Foreign media	[ ]

Advertising activities as a percentage of your agency's total FDI promotion time and budget (please check box)

76 - Budget: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

77 - Time: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

	How many missions or seminars/presentations per year	
Public relations activities, including		
78 - Attending fairs and international conferences and accompanying high-level government delegations abroad	In the country	[ ]
	Abroad	[ ]
79 - Organizing general information seminars/ presentations for foreign investors	In the country	[ ]
	Abroad	[ ]
80 - Organizing sector-specific information seminars/presentations for foreign investors	In the country	[ ]
	Abroad	[ ]

Public relations activities as a percentage of your agency's total FDI promotion time and budget (please check box)

81 - Budget: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

82 - Time: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

Promotional materials (such as brochures, newsletters, video-films, CD-ROMs, etc.) as a percentage of your agency's FDI promotion time and budget (please check box)

83 - Budget: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

84 - Time: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

85 - Other image-building activities you wish to mention (please specify and indicate, if possible, the percentage of time and budget spent on these activities) [ ]
86 - Number of information packages for foreign investors distributed per year [ ]
87 - Number of press releases and briefings per year [ ]

E.2 Investment generation

Unless otherwise specified, the information should refer to the **average for the last three years** (1999–2001), if possible. (See note at the top of section E.)

Table 12: Investment generation activities

ACTIVITIES	Average annual number
Proactively contacting foreign investors	
88 - Total number of foreign investors contacted	[ ]
Of which:	
89 - By face-to-face contacts	[ ]
90 - By phone call	[ ]
91 - By mail or telemarketing	[ ]

Conducting missions abroad targeting specific sectors or enterprises

92 - Number of missions conducted abroad [ ]

Total proactive contacts with investors and missions abroad as a percentage of your agency's total FDI promotion time and budget (please check box)

93 - Budget: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

94 - Time: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

Other activities undertaken by your agency to generate investment directly (please check box)	Average annual number, if any
95 - ☐ Receiving groups of potential investors in your country	- Of missions received [ ]
96 - ☐ Conducting sectoral or market research studies	- Of studies [ ]
97 - ☐ Matchmaking/partnerships	- Of local entrepreneurs for whom you were able to arrange meetings with potential partners: [ ]

Total three above-mentioned activities as a percentage of your agency's total FDI promotion time and budget (please check box)

98 - Budget: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

99 - Time: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

100 - Other investment generation activities you wish to mention (please specify and indicate if possible the percentage of your agency's total FDI promotion time and budget spent on such activities). [ ]

Do you have specific target programs (please check box)

101 - Focusing on large foreign corporations? ☐

102 - Focusing on investors from specific regions/countries? ☐ Please specify [ ]

103 - Focusing on certain sectors? ☐ Please specify [ ]

104 - Focusing on certain forms of investment? ☐

- ☐ Greenfield
- ☐ Joint ventures
- ☐ Expansion of existing investors
- ☐ Other, please specify [ ]

105 - Focusing on privatization? ☐

106 – Other? ☐ Please specify [ ]

107 - Number of presentations made to targeted investors per year [ ]

108 - Number of first visits to your countries by targeted investors year [ ]

109 - Number of return visits to your countries by targeted investors per year [ ]

E.3 Investor facilitation services

Unless otherwise specified, the information should refer to the **average for the last three years** (1999–2001), if possible. (See note at the top of section E.)

Table 13: Investor facilitation service activities

ACTIVITIES	Average annual number of foreign investors assisted
Preinvestment	
110 - Arranging visiting missions of foreign investors: Total	[ ]
Of which:	
111 - Airport pick-ups	[ ]
112 - Organizing meetings with government officials	[ ]
113 - Wrap-up meetings with foreign investors	[ ]
114 - Land and site location investigations and visits	[ ]
115 - Providing information to potential investors	[ ]
116 - Follow-up after investors' visits	[ ]

Total preinvestment as a percentage of your agency's total FDI promotion time and budget (please check box)

117 - Budget: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

118 - Time: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

	Average annual number of foreign investors assisted
Implementation	
Assistance with:	
Registration	
119 - Business registration	[ ]
120 - Tax registration	[ ]
121 - Other (please specify)	[ ]
Licenses:	
122 - Sectoral licenses	[ ]
123 - Other (please specify)	[ ]
Assistance with other services, such as:	
124 - Land and construction approvals	[ ]
125 - Assistance obtaining visas and work permits	[ ]
126 - Assistance with utilities (water, sewerage, electricity, telephone)	[ ]
127 - Legal advice	[ ]
128 - Other business assistance (e.g., domestic employment, customs procedures, etc.) (please specify)	[ ]

Total implementation as a percentage of your agency's total FDI promotion time and budget (please check box).

129 - Budget: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

130 - Time: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

After-care services for existing investors

131- Does your agency have an after-care/investor relation program for foreign investors already present in the country? Y ☐ N ☐

132 - Please specify what type of services you offer to these investors [ ]

133 - Average annual number of foreign investors assisted with such services [ ]

Total after-care services as a percentage of your agency's total FDI promotion time and budget (please check box).

134 - Budget: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

135 - Time: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

136 - Other investor services you wish to mention (please specify and indicate if possible the percentage of your agency's total FDI promotion time and budget spent on such activities). [ ]

E.4 Policy advocacy

Unless otherwise specified, the information should refer to the **average for the last three years** (1999–2001), if possible. (See note at the top of section E.)

Table 14: Advocacy activities

	Average annual number, if any
137 - Articles in press for lobbying purposes	[ ]
138 - Position papers on FDI-related issues	[ ]
139 - Does your agency undertake surveys of investors' perceptions of the domestic investment climate?: Y ☐ N ☐ If yes, how many over the past three years? ☐ none ☐ one ☐ more	
140 - Apart from surveys, do you seek feedback from existing/ potential investors on business environment issues?: Y ☐ N ☐ If yes, please indicate how:	[ ]
141 - Do you systematically seek feedback from investors who decided not to invest in your country? Y ☐ N ☐	
142 - Participation in policy tasks forces or in policy-reform committees/ commissions/boards: Y ☐ N ☐ If yes, in which ones (please specify):	[ ]

Participation in meetings for discussion of domestic investment climate with the private sector	Average annual number of meetings, if any
143 - Total	[ ]
144 - Of which: meetings with chambers of commerce	[ ]
145 - Of which: meetings with other industry representatives	[ ]

Total advocacy activities as a percentage of your agency's total FDI promotion time and budget (please check box)

146 - Budget: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20% ☐

147 - Time: less than 5 % ☐ 5–10% ☐ 10–20% ☐ more than 20%

148 - Who mainly handles policy advocacy matters?

(please check box)

☐ Members of the agency's board or committee

☐ General manager or senior managers

☐ Professional staff

☐ Other arrangement (please specify) [ ]

149 - What percentage of your agency's recommendations to government for policy change, if any, are accepted and implemented?

☐ Less than 20% ☐ 20–40% ☐ 40–60% ☐ 60–80% ☐ 80–100% ☐ not applicable

E.5 Summary table and changes in agency's focus

Table 15: Summary table

	Number of staff	% of agency's total FDI promotion time	% of agency's total FRI promotion budget
150 - A. Image building	[ ]	[ ]	[ ]
151 - B. Investment generation	[ ]	[ ]	[ ]
152 - C. Investor services	[ ]	[ ]	[ ]
153 - D. Policy advocacy	[ ]	[ ]	[ ]

Table 16: Changes in agency focus

If the focus or mix of your agency's functions has changed over the past five years, how have each of the four above mentioned functions (A, B, C, D) changed in importance? (Check box.)

	Less important	Unchanged	More important
154 - A. Image building	☐	☐	☐
155 - B. Investment generation	☐	☐	☐
156 - C. Investor services	☐	☐	☐
157 - D. Policy advocacy	☐	☐	☐

F – PERFORMANCE

Table 17: Main indicators

	1998	1999	2000	2001
158 - Total number of inquiries received by your agency from prospective foreign investors	[ ]	[ ]	[ ]	[ ]
159 - Total number of site visits by prospective foreign investors organized or hosted by your agency	[ ]	[ ]	[ ]	[ ]
160 - Total number of requests for assistance received by your agency from prospective foreign investors	[ ]	[ ]	[ ]	[ ]
161 - Of which: how many where a direct result of your office's promotional activities?	[ ]	[ ]	[ ]	[ ]
FDI projects approved/registered by your agency				
162 - Total number of projects	[ ]	[ ]	[ ]	[ ]
163 - Of which: by investors already established in the country	[ ]	[ ]	[ ]	[ ]
164 - Total FDI value	[ ]	[ ]	[ ]	[ ]
165 - Of which: value of projects by investors already established in the country	[ ]	[ ]	[ ]	[ ]
166 - Total projected value of exports from new investments	[ ]	[ ]	[ ]	[ ]
167 - Total projected number of jobs from new investments	[ ]	[ ]	[ ]	[ ]

If the above data on the FDI projects approved/registered by your agency are not available, please check box ☐ and answer questions 162 to 167 for all projects approved/registered in your country.

Realization of FDI projects approved/registered by your agency

168 - Total number of projects approved/registered by your agency that were actually realized	[ ]	[ ]	[ ]	[ ]
169 - Total FDI value	[ ]	[ ]	[ ]	[ ]
170 - Total number of jobs created	[ ]	[ ]	[ ]	[ ]
171 - Total value of exports generated	[ ]	[ ]	[ ]	[ ]

If the above data on the FDI projects approved/registered by your agency are not available, please check box ☐ and answer questions 168 to 171 for all projects approved/registered in your country.

172 - Realization rate (% of approved projects that are realized within three years)	[ ]	[ ]	[ ]	[ ]

173 - Do you use any other indicator not mentioned above to record the outcome outcome of your agency's promotional activities? Y ☐ N ☐

If yes, please describe. [ ]

(You may provide a statistical annex for this question.)

G – SELF-EVALUATION

Table 18: Evaluation tools

174 - Do you regularly evaluate the effectiveness of your agency's promotional activities?	Y ☐ N ☐
Please briefly describe your evaluation method(s), if any [ ]	
175 - How many times did you undertake a self-assessment exercise in the past three years?	[ ]
176 - How many external performance audits did you have over the past three years?	[ ]
177 - How often are your books financially audited?	[ ]
178 - How many surveys of investors have you undertaken over the past three years to evaluate the performance of your agency?	[ ]
179 - Do you prepare annual reports for your agency?	Y ☐ N ☐
180 - Are these reports publicly available?	Y ☐ N ☐

H – COORDINATION/COLLABORATION

Table 19: Coordination with government agencies

181 - Are there independent regional/subnational FDI promotion agencies in your country?	Number Names	[ ] [ ]
182 - How many times per year on average does your agency meet with these institutions?		[ ]
183 - Are there other agencies dealing with FDI promotion in the country (for instance, special economic zones, industrial zones, free trade zones)?	Number Names	[ ] [ ]
184 - How many times per year on average does your agency meet with these institutions?		[ ]
Is there an established and operational structure for coordination and cooperation		
185 - With the subnational FDI promotion agencies?		Y ☐ N ☐
186 - With other agencies dealing with FDI promotion?		Y ☐ N ☐
(If yes, please describe briefly)		[ ]

Table 20: Collaboration with the private sector

Is there an established and operational structure for coordination	
187 - With chambers of commerce?	Y ☐ N ☐
188 - With industry associations and other private sector groups?	Y ☐ N ☐
How many collaborative activities with the private sector on investment promotion have you undertaken in 2001, in terms of:	
189 - Co-sponsored research?	[ ]
190 - Co-sponsored publications?	[ ]
191 - Co-sponsored workshops, seminars, or conferences?	[ ]
192 - Other (please specify)	[ ]

I – EXTERNAL ASSISTANCE

Table 21: External assistance projects (please check box)

Organization	Technical assistance	Financial assistance	Period during which you received assistance(since date of establishment)	Currently providing assistance
World Bank	☐	☐	[ ]	☐
FIAS	☐	☐	[ ]	☐
MIGA	☐	☐	[ ]	☐
UNDP	☐	☐	[ ]	☐
UNIDO	☐	☐	[ ]	☐
UNCTAD	☐	☐	[ ]	☐
Regional development banks	☐	☐	[ ]	☐
European Union	☐	☐	[ ]	☐
WAIPA	☐	☐	[ ]	☐
Bilateral donors	☐	☐	[ ]	☐
Others (please specify)	☐	☐	[ ]	☐

J – COMMENTS

If you wish to provide comments on some of the questions, or specific information on your agency not covered by the questionnaire, please feel free to provide them here (maximum 3,000 characters). [ ]

Notes

1. Wells, Louis, and Alvin Wint. 1990. *Marketing a Country: Promotion as a Tool for Attracting Foreign Investment.* FIAS Occasional Paper, number 1. Foreign Investment Advisory Service, Washington, D.C.

2. Spar, Debora. 1998. *Attracting High Technology Investment: Intel's Costa Rican Plant.* Washington, D.C: Foreign Investment Advisory Service.

3. www.cepici.go.ci, www.apix.sn., www.investir-au-niger.org.

4. UNCTAD. 2001. "The World of Investment Promotion at a Glance: A Survey of Investment Promotion Practices." United Nations Conference on Trade and Development, United Nations Advisory Studies number 17, UNCTAD/ITE/IPC/3.

5. Although the literature on this issue is limited, a number of benchmarking studies have been undertaken. Some of these have been by consultants for IPAs and are private documents as part of IPAs' own development process. Others, though less rigorous, are more public and have been used as the basis for presenting awards for the best agency of the year, such as that awarded by *Euromoney.*

6. The only empirical examination of the impact of FDI promotion on FDI flows is Wells and Wint (2001). This study had shortcomings in terms of the concept used to measure promotion. See: Wells, Louis and Alvin Wint. 2001. *Marketing a Country, Revisited.* FIAS Occasional Paper, number 13. Foreign Investment Advisory Service, Washington, D.C.

7. The FIAS/MIGA questionnaire used for this survey is in Annex A, and the main responses can be found in the statistical appendix.

8. Although 64 percent of the agencies report some kind of evaluation mechanisms, mainly consisting of actually monitoring the number of projects approved or registered by the agencies, only a handful of them collect information on realization of investments, jobs created, exports generated, and so forth.

9. These two motivations are sometimes referred to as vertical and horizontal FDI. For a good summary on these views, see: Brainard, S. L., 1997. "An Empirical Assessment of the Proximity-Concentration Trade-off Between Multinational Sales and Trade." *The American Economic Review* 87(4):520–44.

10. Of course, abrupt changes in IPA budget are always possible as a result of budgetary crises in government or the termination of external assistance. However, these events occurred in a very few countries of our sample, hence we believe that they will not significantly affect our empirical results that capture trends across a sample of 58 countries.

11. The full dataset is not available for all 75 IPAs included in our survey, because we were able to collect complete budget information for only 58 countries.

12. We used alternative investment climate indicators commonly used in the literature such as *World Economic Forum, International Country Risk Guide*, and so on. The results were similar but more robust (in terms of explanatory power) with the Heritage Index. This index captures 50 independent variables divided into 10 broad factors of economic freedom related to internal and external macroeconomic conditions, economic openness, and political and institutional conditions. The higher the score on a given factor, the worse the quality of the investment climate.

13. Our simulation assumes that one and only one IPA increases its promotion effort at a given time. It is possible that if all IPAs (or at least several of them) increase their budgets simultaneously, the resulting impact on FDI flows would be negligible. The main concern is that the various agencies may end up in a bidding war that results in a "prisoner's dilemma" that benefits the foreign firms at the expense of the winning agency. This view of the world assumes, however, that the overall FDI flows are fixed worldwide and that agencies only compete for their redistribution.

14. Since the IPA budgets vary greatly depending on the level of income in the country, we tested if effectiveness is significantly different between high-income countries and the rest of our sample. We find that the association between the IPA budgets and FDI is higher for non-high-income countries (the elasticity is equal to 0.29 compared to 0.25 for the full sample).

15. We employ a kernel or neighborhood function to estimate the relationship. This method is adaptive and dynamic in the sense that the slope parameter changes along the regression curve depending on the location of the variables in the sample. More specifically, we minimize the weighted sum-of-squared errors between the actual and the fitted by allowing the program to compute a regression at every point in our dataset. A kernel fit is superior to the regression analysis because the latter assumes constancy of the slope parameters.

16. Such initial external assistance has proved to be used in the early stages of the development of the IPA in Cape Verde, Costa Rica, the Dominican Republic, and Honduras.

17. In general, support from the private sector can come in one of three forms: direct contributions to an agency's capital base or budget, payment for specific services, or the provision of staff resources for use by IPAs.

18. For a detailed discussion on the limitations of private funding for an IPA, see: FIAS. 1999. "Strengthening Investment Promotion Agencies: The Role of the Private Sector." Washington, D.C. Processed.

19. Heller, P.S. 1975. "A Model of Public Fiscal Behavior in Developing Countries: Aid, Investment, and Taxation." *American Economic Review* 65(3):429–45.

20. Note this underestimation problem is more apparent for the investor-services and investment-generation functions because they are directed to specific investors, sectors, or both. The image-building and policy-advocacy functions have a more general aim and thus are expected to influence overall FDI flows, beyond the IPA's direct responsibility.

21. Indeed, as recently confirmed by Batra and Moody (2002), variations in cross-country FDI flows are well explained by these factors over the past decade. The Heritage Index captures 50 independent variables divided into 10 broad factors of economic freedom related to internal and external macroeconomic conditions, economic openness, and political and institutional health. The higher the score on a given factor, the greater the

level of government interference in the economy and the less economic freedom a country enjoys. The index assigns scores inversely to the state of the investment climate; hence we expect a negative sign on the coefficient of the estimation.

22. Since our data are cross-sectional, we use the White consistent covariance matrix estimator to estimate the coefficient covariances in the presence of heteroskedasticity of unknown form.

23. Note that in principle, this lag problem would be minimized by using the approved FDI projects in our regressions because there is a minimal lag between the promotion effort and the approval decision.

24. As defined by the ranking of the Heritage Index in our sample of countries.

25. The example cited here is to demonstrate the techniques we used to test for thresholds and external conditions' influence on IPA effectiveness. Our example assumes that the sample of countries is divided into two subcategories but we actually tested alternative numbers of subcategories (2, 3, 4, and 5) and threshold values in our empirical application. We also explored thresholds using quadratic and square root equations.

26. In this case we weight the promotion effort by the actual index value of the investment climate rather than using a dummy variable. In doing so, we have the advantage of not having to choose arbitrary threshold values for our dummy variables, but we must assume a stable relationship between the IPA effectiveness and the investment climate.

27. As defined by the lowest ranking of the Heritage Index in our sample of countries.

28. While these categories are useful, and help structure our analytical work, they present a few limitations. First, it is not always easy to separate all activities performed by agencies and some overlapping can be observed in the survey. For instance, when an agency makes a presentation to a group of investors, it may perform an image-building and possibly an investment-generation activity. Second, even if this conceptual framework is well known today, the degree of familiarity varies across agencies.

29. We observe that poorer countries tend to spend a smaller portion on investor facilitation (27 percent) than richer ones (35 percent), which makes sense given the labor intensity of this function and differences in the human resources available between countries. Further, in percentage terms, poorer countries tend to spend more on image building than rich countries,

34 percent and 22 percent, respectively. However, when absolute values are taken into consideration, rich countries' expenditures in this area are still five times higher on average. Developed countries also spend a larger percentage of total budget on the investment generation function (36 percent versus 29 percent in developing countries), which is not surprising since activities associated with this function are costly and can require highly specialized skills. Both groups spend roughly the same percentage on policy advocacy despite the fact that OECD policy framework tends to be significantly better.

30. We used the approach described in the preceding chapter for the overall IPA budget, but apply it to each IPA function. Unfortunately, these series of tests were nonconclusive in depicting any significant cross-country differences in the estimated impact of each IPA function.

31. Wells and Wint (1990).

32. A negative but weak correlation of –0.27 is depicted between the quality of the investment climate and the share of the IPA budget allocated to policy advocacy.

33. The average for developed countries surveyed stands out as a group with a significantly higher figure, 6,155 per year.

34. Note that this category, implementation, is typically included in pre-investment activities among many IPA experts. We separated this category in our survey to gain a more detailed understanding of activities undertaken in this area, as well as resources allocated.

35. This calculation takes average amount spent on contacts by developing countries (US$186,196) and developed countries (US$1,905,000) and divides each by the average number of investors contacted for each group.

36. An agency with one private representative would report an elasticity coefficient equal to 0.22, while an agency with eight private sector representatives in its board will see its effectiveness increase to about 0.32.

37. From our survey, we found out that agencies report to prime ministers or presidents through alternative mechanisms; a few report to a board of directors that is chaired by the prime minister or the president, while others report only to the prime minister or president. We did not find any significant differences between these two reporting mechanisms in our statistical analysis.

38. Both do require business skills, and each can support the other. Successful investment promotion is likely to lead to an increase in exports. And successful export promotion can well lead to investment as buyers integrate backwards to control their sources.

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