

INVESTMENT CLIMATE IN PRACTICE

INVESTMENT POLICY AND PROMOTION

INVESTMENT REGULATION AND PROMOTION: CAN THEY COEXIST IN ONE BODY?

The World Bank Group's *Global Investment Promotion Benchmarking 2009* report found that nearly three-quarters of countries are missing out on much of the \$1 trillion annual market for foreign direct investment by simply failing at the timely provision of high-quality business information to potential investors. A new study indicates that weak investment promotion is correlated with whether the same government agency is also responsible for investment regulation. This note argues that the two functions should be kept separate and offers policy advice for countries that have them combined.

Nearly every country has an agency responsible for promoting foreign direct investment (FDI). In a 2009 survey of 105 of these investment promotion intermediaries (IPIs), almost 40 percent said that, in addition to FDI promotion, their three main functions included some form of FDI regulation—such as approving investments, managing incentives, and issuing licenses and permits. But the operational needs of promotion and regulation vary so widely that the two functions are nearly incompatible, and promotion almost always suffers when they are performed by the same agency.

In countries with weak investment climates, IPIs may persuade foreign investors to choose their locations for new operations—only to have the investors discouraged or even abandon the investments because of cumbersome licensing, permitting, or registration procedures. Some IPIs may prefer to administer such regulatory

procedures themselves so that they can help investors better navigate them. This one-stop shop approach can simplify procedures for investors, but it appears to make IPIs less effective at promoting FDI. Often attention and resources are shifted toward regulation, leading to an organizational culture and staff skills that serve regulatory functions well but are poorly suited to the sales and marketing needs of promotion.

The Global Investment Promotion Benchmarking (GIPB) project evaluated 181 national IPIs for their ability to perform the critical function of “investment facilitation.” Investment facilitation is the stage of investment promotion which seeks to convert investor interest into an investment decision, as opposed to “investor outreach,” which seeks to generate interest, and “investor servicing,” which helps investors implement investment decisions. Investment

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facilitation is the most basic and common IPI function, making it a strong proxy for IPI performance and the basis of GIPB scores.

Best practice facilitation demands prompt provision of high-quality business information to investors during the site selection process. GIPB scores were based on each IPI's handling of two simulated site selection inquiries and a review of the IPI's Web site, which is often the first point of contact for interested investors. The resulting IPI scores determine their placement in the performance categories of best practice, good, average, weak, and very weak.

Looking at the composition of these categories, there is an obvious and substantial performance gap between IPIs considered “dedicated promoters” and those that are “promoter-regulators.” Best-practice and good IPIs are almost exclusively dedicated promoters, while most lower-ranked IPIs are promoter-regulators. Though being a dedicated

promoter does not guarantee good performance, it is a strong indicator of it (Figure 1).

THE INSTITUTIONAL NEEDS OF PROMOTION AND REGULATION DIFFER GREATLY

The pros and cons of having one agency handle any two separate functions depends on the compatibility of the functions' goals, practices, and needs.

Being a promoter-regulator is like being both cheerleader and referee

Investment promotion aims to attract FDI, while investment regulation ensures that it complies with legal requirements. These requirements typically involve steps to obtain licenses, permits, incentives, or investment approval. As a result, investors contacted by promoter-regulators often become suspicious or confused because they are

FIGURE 1: DEDICATED PROMOTERS VS. PROMOTER-REGULATORS IN GIPB PERFORMANCE CATEGORIES (PERCENT)

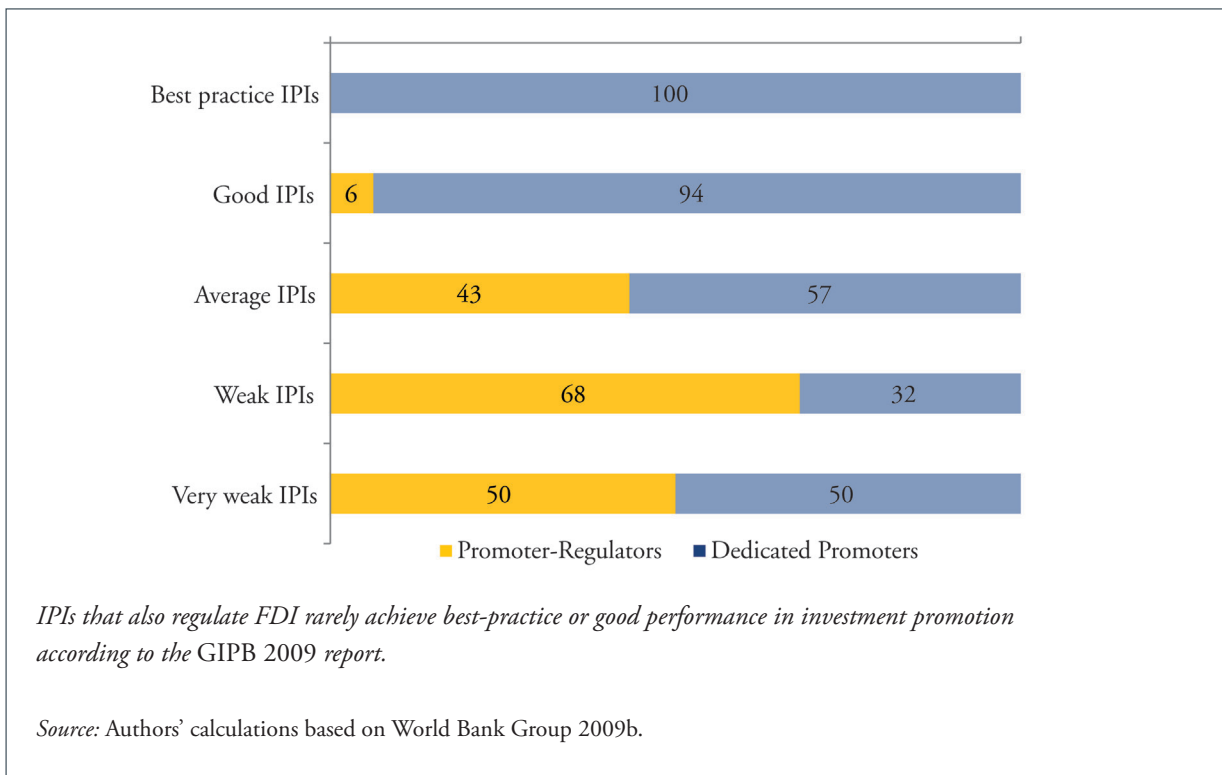


TABLE 1: DIVERGENT NEEDS BETWEEN THE PROMOTION AND THE REGULATION OF FOREIGN DIRECT INVESTMENT

Institutional Dimension	Investment Promotion	Investment Regulation
Organizational culture	<ul style="list-style-type: none"> • Customer-oriented • Private sector focus • Concerned with priority industries 	<ul style="list-style-type: none"> • Compliance-oriented • Administrative focus • Concerned with all FDI
Staff skills	<ul style="list-style-type: none"> • Marketing and sales • Project and customer relationship management • Communications 	<ul style="list-style-type: none"> • Administration • Legal and financial issues • Precision and thoroughness
Knowledge	<ul style="list-style-type: none"> • Business practices • Sector expertise and competitiveness • Laws, regulations, and procedures • FDI data • Foreign languages and business cultures 	<ul style="list-style-type: none"> • Laws, regulations, and procedures • FDI data
Enabling environment	<ul style="list-style-type: none"> • Flexibility within set parameters • Fast approvals and delegated authorities to permit rapid responses to investor needs • Outcome-driven 	<ul style="list-style-type: none"> • Fixed procedures and approval mechanisms • Supervision and audit • Process-driven
Internal systems	<ul style="list-style-type: none"> • Tailored approaches (using defined methodologies) • Quick, flexible responses to investor needs • Follow-up until investor is satisfied 	<ul style="list-style-type: none"> • Standardized systems • Investor requests are met at the speed of the “system” • Follow-up with investor only as required

uncertain whether the IPI is seeking to win their business or to impose what they consider controls or obstacles. This ambiguity may put countries at a disadvantage when trying to promote investment.

Good investment promoters are public sector officials with private sector mentalities

Table 1 compares promotion and regulation across several dimensions and shows clearly that they have greatly different needs in terms of culture, skills, knowledge, enabling environments, and internal systems. This makes them difficult to successfully manage together. Promotion involves a customer-oriented approach, while regulation focuses on procedures. Successful promoters need to have deep knowledge of the private sector and mirror its culture and capabilities to successfully market

investment locations. Staff with the requisite sales, marketing, and customer relationship skills are best recruited from the private sector, but their recruitment may be discouraged by the regulatory side of a promoter-regulator that views the skills as irrelevant and perhaps even as a conflict of interest.

DEDICATED PROMOTERS MEASURABLY OUTPERFORM PROMOTER-REGULATORS IN SIMILAR INVESTMENT CLIMATES

Dedicated promoters add clarity to hazy investment climates

Analyzing the relationship between countries’ *Doing Business 2011* rankings and their IPIs’ scores

from the *GIPB 2009* report makes it clear that IPIs in countries with similar investment climates show a significant performance gap if one is a promoter-regulator and the other a dedicated promoter (Figure 2).

In countries with weak investment climates, effective IPIs may provide investors with their only measures of transparency and predictability. Empirical studies have shown that investment promotion has the greatest impact when it highlights advantages otherwise obscured by red tape and lack of information (Javorcik and Harding 2010). This makes it especially important that IPIs be set up as dedicated promoters.

Still, many governments see regulatory bodies as natural homes for investment promotion efforts due to regulators' experience and knowledge bases. This is often the case in countries where

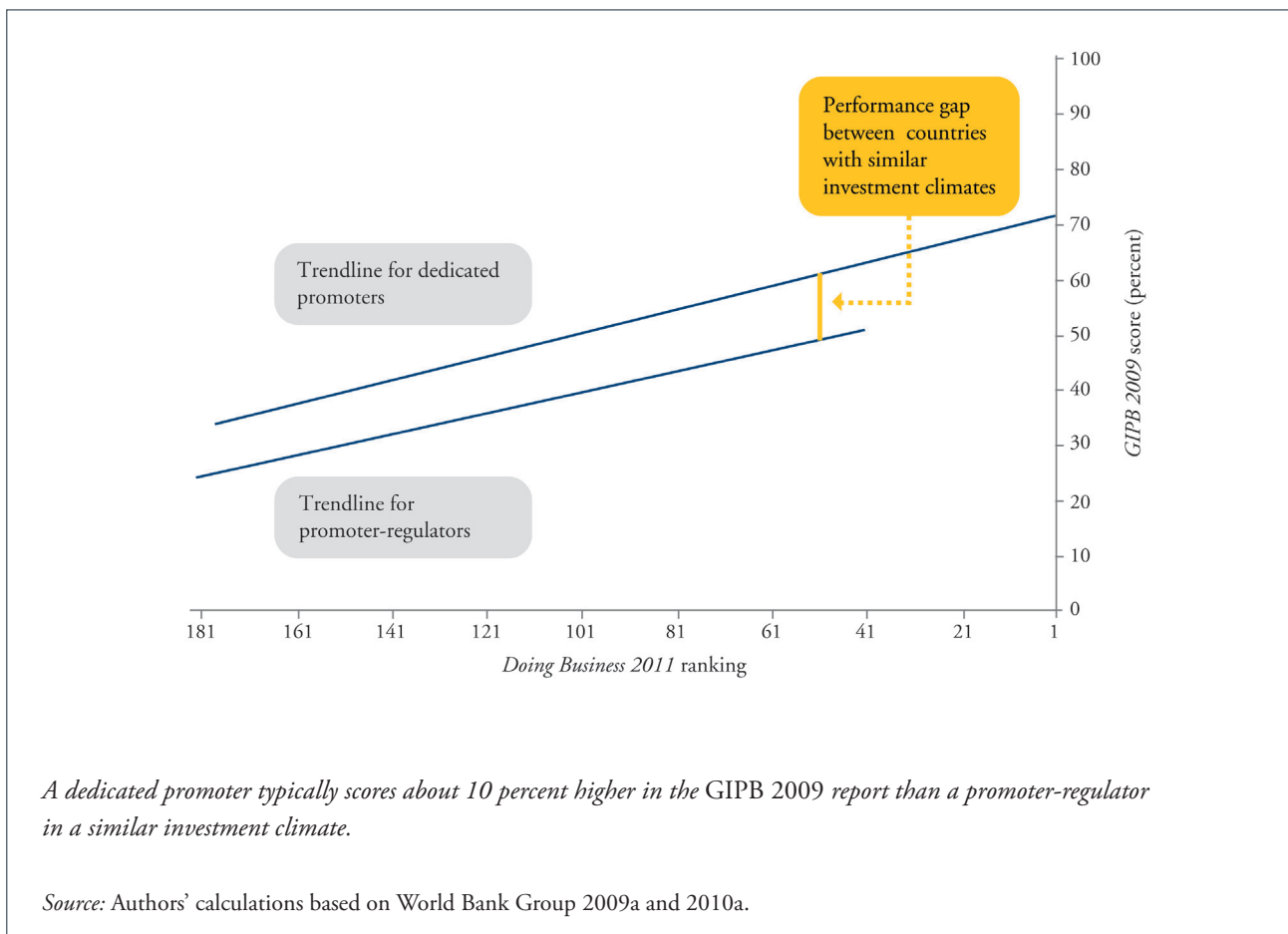
history, culture, and regional norms have led to the creation of strong investment regulators, as with Asia's boards of investment. As investment promotion has become a higher priority, some of these countries have chosen to assign this task to existing investment-related agencies rather than create separate IPIs with a more private sector focus or add the new mandate to more suitable economic development bodies, such as trade promotion organizations.

Promoter-regulators seem unable to advocate a more welcoming investment climate

One of the strongest rationales for combining promotion and regulation is the opportunity for synergy in policy advocacy for regulatory reform.

In other words, the promotional side can become a driver for regulatory reform by using its familiarity with investors to pinpoint critical improvements

FIGURE 2: THE PERFORMANCE GAP BETWEEN DEDICATED PROMOTERS AND PROMOTER-REGULATORS IN SIMILAR INVESTMENT CLIMATES



needed in the investment climate. However, in practice promoter-regulators have a weak track record on driving reform. This is evident from an analysis of the relationship between an IPI's score in the *GIPB 2009* report and the country's ease of establishment index for opening a foreign-owned subsidiary in *Investing Across Borders 2010* (Figure 3). The latter report covers 87 countries, 65 of which were among the 105 covered by the survey for this note.

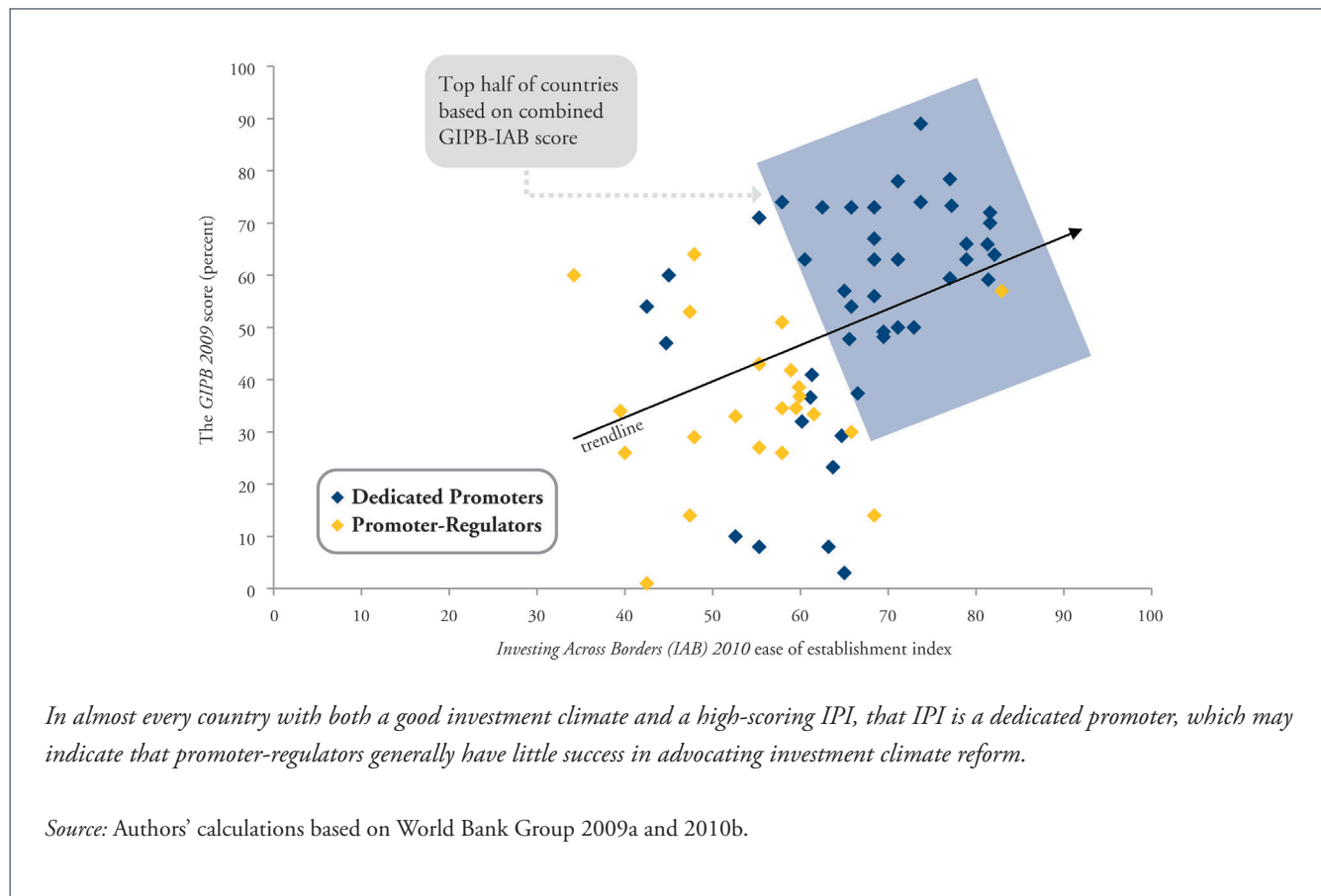
A stark difference is evident in Figure 3 between dedicated promoters and promoter-regulators. Of the 31 countries with the highest combined scores from the *GIPB 2009* report and the *Investing Across Borders* ease of establishment index, all but one rely on dedicated promoters. Countries with dedicated promoters have an average ease of establishment index of 70, meaning it is about as easy to open a foreign-owned subsidiary as in Ireland, the Republic

of Korea, and Spain. Countries with promoter-regulators have an average ease of establishment index of 56, meaning it is about as easy to open a foreign-owned subsidiary as in Ecuador, Liberia, and Morocco.

IMPLICATIONS FOR POLICYMAKERS

Keep promotion and regulation apart: Nicaragua shows that even low-income countries can do it
 PRONicaragua, Nicaragua's IPI, exemplifies the dedicated promoter model. The agency was created in 2002 as a public-private enterprise, independent of regulators, and reporting directly to the office of the president, with a mandate to promote economic growth and job creation by providing foreign investors with information, site visit assistance, and facilitation of government contacts.

FIGURE 3: AN INDICATION OF POOR PERFORMANCE BY PROMOTER-REGULATORS IN ADVOCATING A MORE WELCOMING INVESTMENT CLIMATE



With an emphasis on achieving best practices to attract and retain FDI, by 2010 PRONicaragua had supported investment projects worth \$700 million that could create 49,000 jobs once fully implemented.

Nicaragua also has a separate one-stop shop—part of the Ministry of Industry and Commerce—that handles FDI-related regulatory functions such as company and tax registration. The benefits of keeping regulatory functions out of the IPI are reflected in PRONicaragua’s specialized staff and closeness to both the private and public sectors. The agency’s 25 staff members were hired for their language skills and experience with industries targeted for investment promotion. And while the private sector representatives on PRONicaragua’s board help keep the agency attuned to the concerns and expectations of potential investors, the public sector board members and the direct channel to the presidency give PRONicaragua the political backing it needs to support investors in the country.

One might not expect strong IPI performance in a country with an investment climate ranking of 117 (among 183 countries) in *Doing Business 2011* and that falls in the 26th percentile of the *Investing Across Borders 2010* ease of establishment index. But in terms of promoting investment, as ranked by the *GIPB 2009* report, PRONicaragua was 11th in the world and 2nd in Latin America. Moreover, between 2002 and 2009 Nicaragua moved from 112 to 12 among 233 countries in terms of FDI per capita (UNCTAD 2010).

If promotion and regulation are combined, separate them: Canada shows how

In 1990 only about 50 countries had national IPIs (UNCTAD 2001), most of which were dedicated promoters. Since then the number of IPIs has skyrocketed as countries have recognized the potential benefits of promoting FDI. But many countries have assigned investment promotion efforts to existing regulatory bodies or created dedicated promoters only to later add regulatory functions.

In 1973, a surge of acquisitions of Canadian firms by U.S. corporations prompted the Canadian government to establish the Foreign Investment Review Agency, a purely regulatory agency, to screen foreign investments to ensure that they

provided significant domestic benefits. This focus on regulation continued until 1985, when increasing political openness to FDI led to a shift in FDI-related goals. The regulatory agency was replaced by a promoter-regulator called Investment Canada. Although Investment Canada continued to screen investments, it began promotional functions as part of the ministry of industry dedicated to economic growth and international competitiveness.

Finally, in 2003 the government split the promotion and regulation functions by assigning a much stronger FDI promotion mandate to a new unit, Invest in Canada, under the ministry for foreign affairs and international trade, and leaving investment review under the ministry of industry.

As attitudes toward FDI regulation changed in Canada, its regulatory body adapted accordingly. Meanwhile, investment promotion, which started under the watch of a promoter-regulator, became increasingly valued and evolved into the more effective and separate Invest in Canada—which today ranks fourth among 181 national IPIs assessed by the *GIPB 2009* report.

When weighing options for improving the promotional effectiveness of promoter-regulators, including separating them, it is important to bear in mind that a lot can be done with a little. Several IPIs maintain large promoter-regulator bureaucracies—often with hundreds of employees—that have failed to improve their promotional effectiveness from the “weak” and “very weak” scores assigned by the *GIPB 2009* report. Yet Invest in Austria, the report’s top-ranked IPI, has just 24 employees. This carefully selected small group of FDI promotion professionals can provide expertise on 12 industries in seven languages. Indeed, the 25 highest-ranked national IPIs have a median staff size of only about 40 and include the Cyprus Investment Promotion Agency, which has just 8 staff.

How to make do with a promoter-regulator: Mauritius offers a rare example

Though it is preferable to separate FDI promotion and regulation, it may be financially or politically impossible to do so. Still, the combined functions can be effective if certain steps are taken. Some of the pitfalls of having the two functions controlled by one agency can be avoided by placing them in

different units with their own managers, goals, budgets, and evaluation criteria. The promotion division should have the maximum freedom possible to hire and train appropriately skilled staff. It should also have the information technology systems needed for effective promotion, such as a promotional Web site and internal systems for information and relationship management. Funding sources may see such investments as duplicative and resist allocating the necessary resources, so this is a crucial area for lobbying by IPI managers. A promotion unit can only succeed with the full support of its chief executive and board members.

The Board of Investment of Mauritius is one of just two promoter-regulators among the top 30 national IPIs for promotion worldwide, according to the *GIPB 2009* report. (The other is in Fiji.) In addition to clearly separating promotion and regulation efforts internally, the Board of Investment has worked with the government to streamline the regulatory procedures it oversees, creating an easier investment climate to promote. In recent years it has moved from screening and approving investments to a system of “silent approval” under which only a few types of investment projects are subject to approval and any project not receiving notice of disapproval within a certain period is considered approved.

In addition, the Board of Investment issues licenses for immovable property and free ports. In May 2010 applications for these licenses were put online, providing investors with an exceptionally convenient, transparent process while allowing the Board of Investment to dedicate fewer resources to regulation and more to promotion.

CONCLUSION

FDI fosters economic growth and creates jobs, so investment promotion is crucial to national development. However, FDI promotion efforts can be costly, and countries must take great care to ensure their success. Separating FDI promotion and regulation clarifies staff roles and responsibilities and is now the standard for the world’s most successful IPIs. Though many of the countries that have created IPIs in the past two decades have combined these functions, it is possible and preferable to change course and assign

them to different agencies. The experiences of rich and poor countries alike can be used to guide such efforts, enabling countries at all income levels to attract FDI and advance development. And if it is not possible to separate promotion and regulation, countries can still take steps to improve efficiency and effectiveness in courting foreign investors by internally separating the two functions.

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