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Investment promotion in the new international context: what is the next frontier and how to get there

by
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Investment promotion is an effective policy to address information frictions. Assistance by investment promotion agencies (IPAs) has had significant positive effects on the probability of MNEs establishing a first foreign affiliate (and expanding their presence), at least in Latin America. Importantly, such interventions have been cost-effective: each US$1 spent on investment promotion generates up to US$56 of additional FDI.[1]

While this is encouraging, IPAs face the challenge of remaining relevant and further increasing their effectiveness within a new, more uncertain global environment. The latter is characterized by the digital transformation of the economy, the introduction of a rising number of cross-institutional trade and investment policy interventions, greater awareness that global supply chains have vulnerabilities (and that firms and countries thus need to build resilience), and the sustainability imperative.

To cope with these challenges, IPAs must act simultaneously and in a coordinated manner in several areas, primarily relating to *how* they promote FDI:[2]

- *Go digital*. IPAs need to leverage more and better information and communication technologies to perform their operational functions. In particular, IPAs should draw on the increased availability of specialized digital tools to expand and improve their portfolio of (digital) services and provide their clients with more agile, effective assistance. These include, for example, data collection and visualization tools for investment generation and virtual mapping and site selection and matchmaking tools for investment facilitation. These tools should be fully and consistently integrated into IPA information systems and should ideally inter-operate with those of other relevant entities.[3]

- *Mainstream sustainability and gender equality in promotion approaches and metrics*. Well-defined activity and outcome indicators based on relevant underlying micro- or at least sector-level statistics on pollution, gender and inclusiveness in general should be used for FDI-targeting purposes and become standard components of IPAs' dashboards. These indicators include for instance, greenhouses emissions relative to production levels, the share of women in total employment (or leadership positions) and jobs created outside of capital cities (which is used by IDA Ireland), either for specific MNEs as reported in proprietary ESG or administrative databases or for their respective sectors as computed based on publicly available statistics (e.g., OECD and US BLS data).

- *Improve promotion strategies by making them evidence-based*. There are more than 200,000 MNEs globally, and they differ in attributes and performance measures, including revenues and networks of affiliates. IPAs should make systematic use of trade and multinational production microdata by applying new technologies and methods such as machine learning.[4] These can help IPAs predict the probability of specific MNEs establishing affiliates in their countries and allow them to use this information to guide promotional efforts. IPAs, especially those from developing countries, can build this capacity by working together with international organizations and academia. In fact, the IDB is currently collaborating with several Latin American IPAs in this area.[5]

- *Institutionalize monitoring and evaluation practices* and carry out systematic, comprehensive impact assessments that go beyond direct effects and examine the indirect effects of investment promotion on the local economy.[6] This requires IPAs to generate better data and integrate better third-party data. Specifically, IPAs should: (i) enhance their recording capabilities to generate granular information on the services they offer and their costs; (ii) create and use a consistent, unified register of MNEs established in their countries; and (iii) establish inter-institutional collaborations with the tax, customs and social security agencies, the statistical office, and the central bank to obtain microdata that enable the tracking of sales and purchases between firms and individuals' labor histories across firms over time. Combined with MNE registers, this would help identify transactions and labor turn-over involving foreign affiliates and measure spillovers from MNEs to domestic firms. The experience of Costa Rica's CINDE in conducting this kind of study is illustrative.

- *Coordinate programs as much as possible.* The effectiveness of investment promotion depends on contextual factors such as the institutional ecosystem and other policies. Thus, attracting foreign affiliates and participating in global value chains (GVCs) will be more successful if crossing borders is easy. Investment promotion programs should therefore be coordinated with trade facilitation and export promotion counterparts, as well as with innovation and linkage programs, given the highly integrated nature and complementarities between exports, FDI and multinational production, particularly within GVCs.

When implementing the above recommendations, IPAs should combine longer-term plans with consistent annual action-lines. They should introduce mechanisms such as periodic structured revisions that allow agile adjustments to policy and business conditions that are likely to arise in the new international context.

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[1] This estimate is based on a sample of 12 Latin American countries. See the IDB flagship report on investment promotion for additional details.

[2] Least developed countries' IPAs need to consolidate basic institutional aspects and operational and technological practices to be able to implement these recommendations.

[3] The IDB is preparing a report mapping IPAs' use of innovative digital tools.

[4] Machine learning refers to the use of algorithms that are trained on subsets of data to predict outcomes.

[5] With Costa Rica's CINDE, Invest Chile and URUGUAY XXI.

[6] Insights from these assessments can feed back into monitoring of investment climate and policy advocacy.

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