GOOD PRACTICES IN GOVERNANCE OF FOREIGN DIRECT INVESTMENT IN DEVELOPING COUNTRIES

– Master Thesis –

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Good practices in governance of foreign direct investment in developing countries

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ABSTRACT

Answer to the question whether FDI has a positive impact on development is ambiguous. International organizations promote investment in developing countries, while some human rights NGO provide evidences that FDI has a negative effect on the host country economy. This paper suggests that FDI can be beneficial for developing countries if their governments use the right strategies. Successful FDI policies are built on a stable macroeconomic and political background. Transparency and corruption reducing measures are necessary to both attract and benefit from FDI. In order to manage operations of MNCs, an investment agency should be established. Further, the paper tests the most common policies used by developing countries to manage FDI. It compares costs and benefits of tax incentives, joint venture and domestic content requirement and EPZs, and finds that domestic firms should be treated in the same way as foreign MNCs. The paper also suggests that tax incentive as well as joint venture and local content requirements are not beneficial for the host country.

Key words: Foreign Direct Investment, Development, Tax Incentives, Local Content Requirement, Export Processing Zones
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<th>Acronym</th>
<th>Full Form</th>
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<tr>
<td>CINDE</td>
<td>La Coalicion Costaricense de Initiativas para el Desarrollo</td>
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<td>EPZ</td>
<td>Export Processing Zone</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>MNC</td>
<td>Multinational Corporation</td>
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<td>NGO</td>
<td>Non-governmental Organization</td>
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<td>OECD</td>
<td>Organization for Economic Co-operation and Development</td>
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<td>R&amp;D</td>
<td>Research and Development</td>
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<td>UN</td>
<td>The United Nations</td>
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<td>UNCTD</td>
<td>United Nations Conference on Trade and Development</td>
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<td>US</td>
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1. INTRODUCTION

Foreign direct investment is considered as a driving force of development. This view is promoted by international organizations and agreements: the United Nations, the UNCTAD, the WTO, OECD and the World Bank. Article 20 of the United Nations Monterrey Consensus from 2002 explicitly emphasizes and summarizes the role of FDI in developing countries:

“Private international capital flows, particularly foreign direct investment, along with international financial stability, are vital complements to national and international development efforts. Foreign direct investment contributes toward financing sustained economic growth over the long term. It is especially important for its potential to transfer knowledge and technology, create jobs, boost overall productivity, enhance competitiveness and entrepreneurship, and ultimately eradicate poverty through economic growth and development. A central challenge, therefore, is to create the necessary domestic and international conditions to facilitate direct investment flows, conducive to achieving national development priorities, to developing countries, particularly Africa, least developed countries, small island developing States, and landlocked developing countries, and also to countries with economies in transition.”

(United Nations, 2003)

Oxfam, a development and relief NGO is also promoting expansion of the private sector as a means to allow poor people to access employment, goods, services and credit, along with improvement of income through access to markets. According to Oxfam, business makes the most important contribution to pro-poor development (Oxfam 2007). The OECD Initiative on Investment for Development supports developing countries' sustained efforts to attract and generate more and better investment in order to meet the objectives of the UN Millenium Declaration (OECD). UNCTAD promotes FDI in developing countries by performing the following actions:

“analyses FDI trends and their impact on development; compiles data on FDI; provides advisory services and training on international investment issues; helps developing
countries improve policies and institutions that deal with FDI; and helps these countries participate in international negotiations on investment”. (UNCTAD, 2002)

The Doha Ministerial Conference of the WTO, describes trade liberalization as ‘an opportunity’. In order to ensure fair benefit sharing with developing countries, it recommends technical assistance in the management of FDI (WTO 2001). The World Bank is promoting FDI by, among other, granting IDA credits to establish investment agencies in developing countries (World Bank 2007b).

But is this enthusiasm for FDI supported by empirical researches and case studies? The recent study of Qi, which examines the long-run and short-run relationship between growth, total investment and FDI in 47 countries using an error-correction model gives an ambiguous answer. While the long run causality between growth and total investment is uniformly positive, long-run causality between growth and FDI is negative in some cases, especially in Africa and oil-exporting countries (Qi, 2007). Also human rights NGOs show terrifying case studies, mainly from Africa, where MNCs abused their power and exploited resources without paying taxes and contributing to the social protection of its workers. Some of the oil corporations even sponsored armed conflicts which lead to the civil war like in Angola, Congo Brazzaville and Equatorial Guinea (Global Witness, 2004).

This paper will address the problem of investment policies used by host countries. In particular it will examine whether FDI has an impact on development and under which conditions a host country can benefit from them.
2. AIMS AND METHODOLOGY

Much of the academic literature on FDI focuses on policies necessary to attract them to developing countries. Case studies described by journalists and NGOs give very broad recommendations for the host countries and tend to focus on transparency, reduction of corruption and strengthening of institutions, which in many developing countries is not feasible in the short-run. There is very little research done on policies that allow developing countries to benefit from FDI in the duration of one or two terms of office. Therefore the primary research questions of this paper are:

Is FDI beneficial to the host developing countries?
When does it have a positive effect? When does it have a negative effect?
What policies should host countries adopt to maximize the benefits from FDI?

In order to address these questions, the paper will utilize an interpretive methodology to analyze the existing literature and case studies. The study will be concluded with the recommendations for the host economies towards harnessing FDI for development. First, this paper will examine FDI trends from the years 1980 till 2005 and analyze opportunities and threats imposed to the host countries by this capital flow. Second, this paper will identify policies used by recipient countries to manage FDI and analyze advantages and disadvantages of them in order to extract the strategies which are the most beneficial for developing countries. The following policies will be assessed: analysis of the country’s development objectives, providing tax incentives, requiring domestic content and establishing export processing zones. Finally, recommendation will be drawn on the basis of this analysis in order to give guidelines for the policymaker in developing countries that host FDI.
3. IMPACT OF FOREIGN DIRECT INVESTMENTS

3.1 Trends

The recent 20 years is characterized by trade liberalization, integration of the financial markets and dramatic rise in the flows of FDI. In the late 1990’s, spurred by cross-border merges and acquisitions, the level of FDI started to increase. This sharp rise continued till it reached the peak in 2000 and started to fall immediately afterwards following the stagnation of developed economies, in particular in the EU and Japan. In 2004 however, FDI flows picked up again. The current level of FDI is substantial and reached $916 billion in 2005 (UNCTAD, 2006).

Figure 1. FDI inflows by group of economies, 1980–2005 (Millions of dollars)

Source: modified from UNCTAD’s Interactive Database, data available at http://stats.unctad.org/FDI/TableViewer/tableView.aspx
In 2005 inward FDI in developing countries reached $334 billion as the result of a rise by 22% in 2005 and 57% in 2004. FDI is the largest component of net resource flows to developing countries (Figure 3). A debt crisis in 1980’s and drying out of commercial bank lending were factors that started this trend. (Asian Development Outlook 2004). FDI are very important for poor countries, where development is constrained by the lack of capital caused by insufficient savings. FDI is also attractive alternatives to the bank loans because it provides a more stable source of capital. In case of FDI it is the MNCs that take the risk and are liable in case of bankruptcy. Another advantage of FDI is that unlike bank loans, the capital flow doesn’t have to be paid back.
3.2 Opportunities for developing countries

FDI provides many potential benefits for developing countries. Asian Development Outlook 2004 summarizes them as follows:

- Inflow of superior technology,
- Increased competition in the host economy,
- Increased domestic investment,
- Access to export markets arising either from foreign firm economies of scale in marketing or from their ability to gain market access abroad,
- Aid in bridging a host country foreign exchange gap (Asian Development Bank, 2004).

Kaminski and Smarzynska emphasize the role of MNC in transitional economies as a driving force of development of export. The case of Poland showed that this country benefited from FDI by integrating into global production and distribution networks. Also
increase in FDI in service sectors lowered the transaction costs and indirectly affected export by attracting investment in manufacturing (Kaminski and Smarzynska, 2001). Moran is arguing that FDI is the source of beneficial spillovers, externalities and bringing ‘new ideas’ to the developing countries. FDI is opening the host economy for R&D, production processes, quality control procedures and cutting edge strategies for the performance on international markets (Moran, 2006). In addition to this, there are other potential benefits for the host country from FDI, which were described in the introduction: employment, increased entrepreneurship and eradication of poverty through economic growth and development.

### 3.3 Hazards for the host countries

Although FDI has the potential to contribute to the host country development, it can occur only under some conditions. Poor investment policy of the developing countries governments and lack of transparency can turn the blessing into a curse.

The most visible risk of FDI is caused by corruption and lack of transparency. Global Witness, a British NGO, is regularly publishing reports about fraud, mismanagement of public income by host country officials and vanishing tax money in the developing countries endowed in natural resources. The organization is pointing out that the ordinary citizens, without knowledge about real revenues, are left marginalized and at the mercy of donor assistance. The problem is huge, in Angola for example, one in every four oil dollars earned goes missing. Another example is logging by Tamann Industrie Limited in the Democratic Republic of Congo, where corrupted government allowed chopping down part of the unique jungle without taking precautionary measures to protect local people and endanger species. Benefits went only to the officials. Ordinary citizens were left worst-off without homes, employment, and chance to survive (CED, Cameroun - Rainforest Foundation, UK & Forests Monitor, 2003).
Disadvantageous FDI can also lead to the crowding-out effect, which can have a negative impact on the developing country’s economic growth in the long-run. Rich and experienced MNCs, particularly in the presence of the corrupted government, can destroy competitors and change the market structure into monopoly. In addition, the establishment of factories that are focusing on simple assembling rather than production, blocks positive externalities like know-how spillovers and skills upgrading. Moran describes it as the ‘screw-driving operations’ (Moran, 2006).

There have been also strong concerns in some export processing zones that labor or environmental standards might be lowered as a result of the “race to the bottom”. Governments, to attract FDI, restrict union’s rights and offer too costly incentives which reduce the net benefit form investments. At the end, public money, instead of being spend for social protection of the citizens, are used to benefit foreign investors and shareholders (Januch, 2002).

The following chapter will examine the most common policies used by host countries to govern FDI and will assess their impact on economy. The goal of this analysis is to find out which strategies create opportunities and which impose hazards.

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4. ASSESSMENT OF THE INVESTMENT POLICIES IN HOST COUNTRIES

4.1 Analysis of the country development objectives

There is a consensus among scholars that a country is attractive for FDI only if the overall economic situation of the recipient is stable and predictable. Also, globalization is shifting the FDI pattern from market-seeking to export-orientated investment. (Nunnenkamp, 2001). FDI statistics and investors surveys revealed that MNCs search for countries abundant in skilled labour and a good supplier’s network rather than just cheap workforce or financial and fiscal incentives (Morisset and Pirnia, 2001). According to Moran, FDI in electronics, auto parts, chemicals, industrial and medical equipment, and business services are 20 times greater than the flow to garments, footwear, leather production, and toys. Progress in investment into low-skilled to slightly higher-skilled operations results in two to five times higher wages and more prevalent access to health care, child care and job trainings (Moran, 2002). Therefore, it is important for the host countries which want to harness FDI for development to use policies directing capital flows to the technologically advanced sectors. The case of Costa Rica proves that outlining country development objectives and designing the strategy in a way that FDI is directed to skilled labor operations is the first level of the successful investment policy.

Until the mid 1980s, Costa Rica did not attract much FDI. Poor economic performance and lack of clear development policy deterred MNCs. To promote investment, policymakers focused first on creating sound macroeconomic policies and fighting inflation. Also, the exchange rate was corrected to a realistic level. Second step was to allow EPZs in industrial parks near to the capital, because only there the infrastructure was properly developed. The result was encouraging: $368 million in investment, which generated 37,000 jobs, although FDI went almost exclusively in the garment industry (Moran, 2006)
In 1992 the Costa Rican government decided to restructure its investment promotion agency called CINDE. To keep competitiveness in labour-intensive manufacturing (low wages), policymakers decided to diversify the foreign investment base toward higher-skilled operations. The agency conducted a major review of the country strengths, opportunities and resource endowments. On this basis, the national development plan was formulated. To design a policy suited for hi-tech sectors, CINDE researched the needs of companies in semiconductors, medical equipment, pharmaceutical and business service. Simultaneously, Costa Rican government launched a national educational program. It established vocational high schools and public junior colleges to train new generation of high-skilled workers.

As a first large investor CINDE have chosen Intel, a producer of semiconductors. The negotiation wasn’t easy. When the company demanded better infrastructure, the Costa Rican president approved construction of the new cargo terminal at the national airport. When Intel asked for trained workers, CINDE proposed a joint training program between Intel’s human resources executives and the workers of Ministry of Education as well as the Costa Rican vocational institutes. To close the deal, CINDE offered an exemption on income tax for the first 8 year and a 50% exemption for the next four.

Although first large FDI demanded huge effort from CINDE and was very costly, there is no doubt that it was worth it. Only in three years after the arrival of Intel, Costa Rica tripled its stocks of FDI to a total of $1.3 billion, with annual export of $3.3 billion. The investment promotion strategy used by CINDE is currently considered as a model for other developing countries (Moran, 2006)

Case studies of the Malaysian and Korean FDI strategies reveal another tool which can be used by policymakers to increase productivity. Both countries used a policy which systematically raised wages. Companies, in order to cut costs invested in new technologies and training workers, which resulted in higher productivity. In addition, the wage policy positively influenced labour-intensive production activities aimed for export

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2 Republic of Korea
by supplying them with semi-skilled workers which became redundant because of technological upgrading (Sauvant and Tesfachew, 2005).

The lesson for this sup-chapter is that before promoting their country as a location for FDI, policymakers should first produce an analysis of the country growth objectives. This analysis should study countries strengths, weaknesses, opportunities and threats. It should also examine country’s endowments as well as the investment policies of the neighboring states. This should allow policymakers to decide which sectors will be the most valuable for development. Second step is a preparation of FDI-friendly macroeconomic, microeconomic and institutional environment. Build up strategies, as Moran describes them, consist of: keeping the inflation, establishing realistic exchange rate and tax regulations in line with the international standards, in the presence of transparency and fair judicial system (Moran, 2002). Third step is the preparation of infrastructure, training workers and supporting domestic firms. The latter will become future suppliers of foreign MNCs or competitors, who can learn from foreign FDI, benefit from economies of scale and prevent monopoly.

4.2 Tax incentives

Policymakers in developing countries use tax incentives to attract foreign investors and benefit from capital inflow and externalities. Incentives can take the form of direct subsidies (cash payments, free land or infrastructure) or indirect subsidies (tax breaks, protection against competition and import protection). They are available only to some specific investors or types of investors.

There are arguments both pro and against tax incentives for foreign investors. The argument pro is that incentives attract investors and increase the amount and value of FDI. The other is that a country without preferential tax systems will loose investors, which would move to alternative countries that provide this kind of incentives. Thus incentives,

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3 SWAT analysis used in Marketing
according to its supporters affect both aggregate of FDI and its location. The arguments against preferential tax systems for foreign investors focus on the cost/benefit analysis. Both studies of Allen and Wells and of Blomstrom and Kokko showed that the cost to the public exceeds the benefits created by FDI (Allen and Wells, 2001)( Blomstrom and Kokko, 2003). Moreover, the investor’s survey conducted by Morisset and Pirnia showed that investors tend to rank tax incentives quite low as determinants of investment and they value more skilled labour and the general economic condition of the host country. Therefore tax money should be used for education rather than tax incentives in order to ensure long-term development from FDI.

Another argument against tax incentives shows that the preferable treatment of foreign investors can lead to a crowding-out effect, and leave domestic businesses worst-off. It is very important for developing countries to give the same opportunities to all investors. The best example of the advantages of such policy is Ireland, which for a long time was considered a preferred location for FDI and was named a European Tiger for its outstanding economic growth. All the investment incentives in Ireland: low taxes, good infrastructure and access to the EU market were also available to the domestic companies and allowed them to develop simultaneously with foreign firms (Blomstrom and Kokko, 2003). The essay of Foreign Investment Advisory Service also points out, that fair taxation and support for investment should be available to foreign investors as well as to domestic ones.

Allen and Wells studied the case of Indonesia, were tax incentives for foreign investors were offered for some period of time and than stopped in another period. The experiment proved arguments against tax incentives because again neither the amount of FDI changed nor did the location. The essay also revealed that the abolishment of tax incentives for foreign investors was connected with a tax reform which reduced the corporate income tax. The conclusion which can be drawn from this case is that the elimination of tax incentives does not affect the level of FDI as long as the host country offers a tax regime which is in line with the international norms (Allen and Wells, 2001).
Global Witness is also classifying acceptance of liability sheltering and transfer pricing as a preferential tax system used to attract MNCs (Global Witness, 2006). Liability sheltering means that the parent company uses subsidiaries to make debts and go bankrupt, while the whole group is protected from liability. Transfer pricing occurs when two or more businesses trade with each other although they are owned or controlled by the same organization or people. If the price of transfer is established on the market level, the taxation is fair. However MNC can also fix the price at lower level to reduce the value of taxes, which results in lower national welfare (Global Witness, 2006). Transfer pricing and liability sheltering are bad policies that can obviously leave the host country worst off. To avoid them, the involvement of the MNC’s home countries is necessary, which should require greater transparency from their corporations. Also, the international community and organizations like the WTO should negotiate trade agreement to coordinate transparency policies and avoid beggar-thy neighbor policies.

The question which arises after studying the arguments pro and against tax incentives is: Why do policymakers continue to use tax incentives to attract FDI? Foreign Investment Advisory Service suggests that the problem lies in the FDI agencies which are responsible only for attracting FDI and not making them beneficial for the host country. This lack of responsibility for the outcome from FDI leads to a non-cost-effective behavior. Many policymakers still fear that the lack of tax incentives will result in change of the location of FDI (although the empirical evidence doesn’t support this opinion) (Morriset and Pirnia, 2001). It is therefore important that the elimination of tax incentives in initiated through multilateral trade agreements, for example on the forum of the WTO, so the policymakers, especially in developing countries, won’t fear loosing FDI. Host countries will be able to benefit from them and use companies income tax not for subsidies but for education of labor and infrastructure.
4.3 Joint venture and domestic content requirements

Both economist and policymakers know that FDI benefit the economy not only through capital flow but also through positive externalities like technology and know-how spillovers as well as skill upgrading. It allows domestic producers to learn from foreign MNCs and become more competitive. Thus policymakers try to develop strategies which would encourage linkages between foreign and local enterprises.

For some governments the most obvious policy is joint venture and domestic content requirement. They assume that foreign MNCs, which are obligated to work together with local firms or use local suppliers, would transfer know-how and technology to the host economy. However, there is no empirical evidence proving this belief. According to Moran, in Latin America joint venture and domestic content requirement generated prices for locally produced computers 150-300% higher than international average. Technology was also less advanced than in the computer models available on the open market. Hewlett Packard and Apple used Mexico’s protectionist policy and joint venture requirement to change the market structure into oligopoly. Those companies could offer old technology and poor services to the Mexican consumers, because they were not threatened by competitors (Moran, 2006).

Another argument against joint venture and domestic content requirement is based on the evidence that wholly owned affiliates contribute in a better way to spillovers and skill upgrading. Slaughter’s empirical findings revealed a robustly positive correlation between skill upgrading and the presence of affiliates of U.S. multinationals in both developing and developed countries (Slaughter, 2002). Also Javorcik and Spatareanu confirmed a positive intra-sectorial spillover resulting from wholly-owned foreign affiliates in Romania (Javorcik and Spatareanu, 2006).

What makes foreign companies invest more in wholly owned affiliates? MNCs are competing on the international markets and are using economies of scale as well as standard procedures to stay competitive. In order to perform operations on the highest
level, they need to have total control over the affiliate. It is especially true for production which requires advanced technology. Moran is also pointing out a new paradigm of FDI. MNCs provide “parental supervision” for its affiliates if they are fully owned. They train managers and import cutting-edge technologies. Transfers of technology and exchange of managers and technicians between headquarters and subsidiaries is also more prevalent in the absence of joint venture and local content requirement (Moran, 2006).

Foreign firms also show a strong motivation to develop a network of suppliers in the host country. MNCs provide recommendations as well as technical assistance for its suppliers in order to ensure highest quality and the lowest cost of components (Moran, 2006). So-called “backward linkages” have huge impact on the economic growth of the host country. They increase competitiveness of the local enterprises by giving them the opportunity to gain economies of scale and learn cutting-edge technologies in production and management. Although the research of Javorcik and Spatareanu is not consistent with these findings⁴, Moran shows that backward linkages were present in Malaysia, Indonesia, Thailand and Czech Republic (Javorcik and Spatareanu, 2006) (Moran, 2006). The outcome of the analysis from Romania could have been influenced by poor performance of domestic enterprises, which are not used to an open-market economy.

In order to facilitate spillovers, governments in host countries should strengthen domestic enterprises, so they are present on the market when MNCs are arriving. Also policymakers should attract FDI to sectors that are allowing spillovers to local firms. Comparison of the investment strategies in Asia to those in Africa reveals that linkages occurred in the former, because service, assembly and manufacturing operation tend to generate many opportunities for domestic producers. In Africa, focusing on the mining industry resulted in little backward linkages because domestic firms couldn’t afford neither technology nor the specialized mining equipment. (Sauvant and Tesfachew, 2005)

⁴ In case of Romania, MNCs investing in the greenfield operations tend to use foreign suppliers
4.4 Export Processing Zones

Until 1970’s policymakers and economist were strongly influenced by the belief that economic development should be fueled by strongly protected domestic manufacturers. The strategy used in this period by governments is called import-substituting industrialization. Starting from the 1970’s and till the late 1980’s the trend changed and import-substitution became widely criticized. It was not only costly, but also inefficient and disadvantageous for consumers. Producers from small developing countries couldn’t gain economies of scale and separation form international markets resulted in primitive technology and poor managerial skills (Krugman and Obstfeld, 2006). The shift in policies from import-substitution to export-oriented industrialization began in Asia. Rapid growth in Japan after World War II, followed by four “tigers” in 1960s: Hong Kong, Chinese Taipei, South Korea ad Singapore and in 1980s also by Malaysia, Thailand, Indonesia and China proved that export-oriented industrialization is the right strategy for development.

Policymakers from developing countries, charmed by the “East Asian miracle”, designed policies boosting export. One of them is establishment of the export processing zones. According to the World Bank an EPZ definition and role is as follows5:

“Traditional export processing zones are fenced-in industrial estates specializing in manufacturing for exports. Modern ones have more flexible rules, such as permitting more liberal domestic sales. They provide a free-trade and liberal regulatory environment for the firms involved. Their primary goals: to provide foreign exchange earnings by promoting non-traditional exports, to provide jobs and create income, and to attract foreign direct investment and attendant technology transfer and knowledge spillover. Domestic, international, or joint venture firms operating in export processing zones typically benefit from reduced red tape, flexible labor laws, generous long-term tax holidays and concessions, above-average communications services and infrastructure (and often subsidized utilities and rental rates), and unlimited duty-free imports of raw and intermediate inputs and capital goods needed for production. one of many export

5 The World Bank view expresses both in the paper of Dorsati Madami (1999) and in the PREM notes on Economic Policy (World Bank, 1998)
Although EPZs serve for the purpose of boosting growth, their effect on development varies among countries. Advantages and disadvantages of EPZs will be described on the basis of two case studies: Namibia and Mauritius. Those two countries were chosen because their both are located on the African continent, which performs the worst in the world economic growth. The success story of Mauritius, based on the article of fDi Magazine, will try to explain what a country like Namibia should do to benefit from FDI in EPZs (the case of Namibia based on Jauch, 2002).

Mauritius, as an example of a successful EPZ policy will be evaluated first. When the tiny island on the Indian Ocean proclaimed independence in 1968 its economy was depending only on sugar cane and was vulnerable to the negative effects of the changes in prices of this commodity. Therefore, at the end of 1960s, the government sent a team to study export-oriented policies of Hong-Kong, Jamaica, Puerto Rico, Singapore and Taiwan. Establishment of the EPZ became the result of this study. In the early 1980s foreign garment investors began to arrive. They brought new ideas about managing clothing production and navigating the complex import quotas in developing countries. It was also easy to establish companies because this sector requires only modest amounts of capital and sewing equipment was available on the world market.

The role of the State was significant in the development of Mauritius. It established an Industrial Coordination Unit and the Ministry of Industry to manage FDI more accurately. Also domestic firms were granted the authorization to invest in the EPZ and benefit from technology and skills spillovers and skills upgrading opportunities. By the early 1990s Mauritius’s EPZ was able to produce internationally competitive products, inserting itself into several international commodity chains (fDi Magazine, 2004).

Protection was also a part of the story of Mauritius's success. The IMF ranked Mauritius as one of the most protected economies in the world in the 1990s. Local firms were
treated preferentially to foreign producers. Moreover, around 50 per cent of the equity of firms producing for exports was nationally owned (2003). Mauritian government used protectionism to aid not only development of domestic firms, but also to protect farmers from some of the negative effects of trade liberalization (Christian Aid, 2003).

Namibia on the other hand, is an example of disadvantageous EPZs, where the policymakers misunderstood the purpose of offering special treatment to investors. In 1995 President Sam Nujoma suspended national labour laws in EPZs in order to attract more FDI. Trade unions and striking became illegal. The study in the year 2000 revealed that this policy was not worth its cost. Only 400 jobs were created from 25,000 targeted in plans from 1995. It is also obvious, that overall low labour standards in a country give no incentives to foreign investors to establish high labour standards in their affiliates.

Despite the skepticism about the Namibian EPZs, the Ministry of Trade and Industry continued to attract FDI, using any method available. In order to show some success, EPZ status was granted to mining companies (copper, zinc and refinery), which were also allowed to benefit from tax exemption from their profits. Namibian government tried also to attract an investment of the value of $ billion from the Malaysian textile company Ramatex which would create 3,000-5,000 jobs during first two years and 2,000 jobs in the following two years. The Ministry of Trade and Industry offered a package which included: subsidized water and electricity, a 99-year tax exemption on land use and the preparation of $ 60 million infrastructure for the plant which would include electricity, water and sewage. There is little proof that all those costly efforts resulted in high benefits for the country and its people.

Unfortunately, Namibia is not an exception in the South African region. The government in Zimbabwe also suspended labour laws in its EPZs. Mozambique’s law guarantees some basic working conditions, but extreme poverty, high unemployment rates and lack of experience of trade unions make these laws unlikely to be enforced.
Effects of EPZs in the region were so miserable, that in 1995 the Souther Africa Trade Union Coordinating Council (SATUCC) passes a resolution stating its opposition to EPZs as a development strategy for Southern Africa. EPZs were accused of bringing down labour, environmental and health standards. They also were identified as a threats to industrial democracy, sustainable development and regional integration (Jauch, 2002).

Why the case of Mauritius differs so much from the cases from the South African region? South African countries lack clear strategies. Domestic firms could not benefit from the spillovers and economies of scale. There were no investment agencies which examine possibilities arising from the presence of foreign MNCs in order to ensure benefits for the local producers. Also South African countries focus on attracting FDI to low-skilled, cheap labour. To compete for FDI they lower labour standards and provide too many incentives (“race to the bottom”). The last reason why EPZs are disadvantageous for the South African region is increase in competition between those countries. In case of Africa, cooperation would bring more benefits and allow those countries to achieve together economies of scale (Jauch, 2002). The World Bank gives further recommendations for the policymakers who are planning to establish an EPZ:

- Monetary and fiscal policies should be sound and stable and private property and investment laws should be clear
- There is no need for overly generous tax incentives, but EPZ should be moderately taxed
- Utilities should not be subsidized because it discourages rational use of resources
- Providing infrastructure like phone lines, roads and harbors is good for both foreign and domestic investors as well as for the citizens
- Labour laws should not be lowered; protection of its people is of the country ‘s utmost importance. Moreover, labour standards and higher wages result in the increase in productivity
- Domestic producers should be given the same privileges as the foreign ones (World Bank, 1998).
5. GUIDELINES FOR DEVELOPING COUNTRIES

The diagram below presents the summary of the findings from the previous chapter. The purpose of these guidelines is to give policymakers a clear schedule for the development of the foreign investment strategy. Every developing country willing to maximize benefits from FDI should go through this kind of schedule and implement all the steps, because, as this paper suggest, successful FDI policy is well planned and contains development objectives based on a sound cost/benefit analysis.

Figure 3: Guidelines for developing countries, which plan to harness FDI for growth

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<th>Step one: Prepare economy and legislation</th>
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<td>Focus on: inflation, exchange rate, property and investment laws and judicial system.</td>
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![Diagram]

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<th>Step two: Support entrepreneurship and invest in human capital</th>
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<th>Step three: Establish an investment promotion agency</th>
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<td>The agency should not only attract FDI but also be responsible for the effects of the investments.</td>
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<th>Step four: Conduct an analysis of the country development objectives</th>
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<td>Analyze country’s strengths, weaknesses, opportunities and strengths; examine endowments; study neighboring countries economies.</td>
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<th>Step five: Encourage domestic firm to invest in the country’s strategic sector</th>
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Step six: Eliminate red tape

Step seven: Build necessary infrastructure
Infrastructure serves not only to foreign firms but also to domestic producers. But remember that subsidizing utilities discourages rational use of resources.

Step eight: Create a tax reform in line with international standards
Since tax incentives are usually too costly and can lead to the “race to the bottom”, a tax reform is recommended.

Step nine: Create labour laws and support trade unions
High labour standards don’t discourage FDI because MNCs are used to them. Trade unions can be useful in enforcing labour laws.

Step ten: Open an export processing zone available also for domestic firms
Presence of domestic firm is necessary to benefit from positive externalities.

Step eleven: Allow MNCs to invest in wholly owned affiliates
This will encourage technology transfers and skill upgrading.

Step twelve: Use income from taxes to improve infrastructure and skills of labour
Better infrastructure and skilled workers will attract FDI that generate higher income and provide more valuable spillovers.
6. CONCLUSIONS

FDI can be beneficial to the host country and contribute to development through economic growth and increase of welfare fueled with spillovers, skills upgrading and bringing new standards. However, the benefits don’t come automatically and it is up to the governments of host countries to develop intelligent policies, which would squeeze out the maximum from FDI. This paper analyzed and assessed several investment policies: Total country analysis, tax incentives, joint venture and domestic content requirements and establishment of Export Processing Zones. The findings, summarized in the “Guidelines for policymakers” revealed that in order to benefit from FDI developing countries have to: prepare national development goals, support entrepreneurship and improve economy and business environment and ensure transparency before attracting MNCs. Afterwards, specialized investment agencies should be established. Their role is important in comparing the cost of providing incentives with benefits from FDI. Investment agencies should also be responsible for facilitation of spillovers and skill upgrading through policies described in this paper.

There is also a role for international organizations and developed countries in making FDI beneficial for developing countries. MNC’s home countries should promote transparency of FDI finances and provide technical assistance for recipient countries. International organizations should become the forums for multilateral negotiations which would solve problems like low labour standards or exaggerated tax incentives. Doing this should stop the “race to the bottom” of developing countries.
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