WORLD BANK GROUP
Trade & Competitiveness

FIFD Workshop on Investment Facilitation for Development

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I. Introduction

Good morning and thank you for inviting me to this exciting panel.

One thing is clear about today's trade and investment landscape: it is evolving. And at the crux of the changes are global value chains and technological innovations which have allowed more players than ever to participate in global markets.

While these forces have helped reduce poverty and drive development in many countries, others continue to be left out. FDI can bridge this gap. Allow me to say why this is so for three main reasons. First, by recalling the importance of FDI to the development process; second, by emphasizing how maximizing the benefits of FDI requires that a smart policy framework be in place: and third by noting how different types of FDI carry differing development footprints.

II. Why FDI is Important

Foreign direct investment is critical to bridging the development divide. FDI connects economies to capital and global markets. It can increase productivity through spreading know-how and technology. And, it helps create more and better jobs.

Vietnam - a country with limited capital and technological resources - implemented reforms in the late 1980s to attract multinational corporations. This investment has paid off: FDI has transformed Vietnam from a poor agricultural economy to a middle-income exporter – of textiles, mobile phones and computers. A two-decade record of strong per capita growth has made it even more attractive to investors, and FDI flows have reached record levels in the past few years. Initially attracting investment in lower-level manufacturing such as textiles, a $1.04-billion assembly, testing and manufacturing plant established over a decade ago by Intel corporation continues to help Vietnam move up the global value chain and bolster its human capital. Other large investments, such as that by Singtex, a high-tech fabric maker, and multibillion dollar investments by Samsung, keep Vietnam positioned to specialize increasingly in high-tech manufacturing. In 2016 Vietnam exported over $40 billion worth of phone devices, nearly $15 billion worth of integrated circuits, and $4 billion computers.

Mexico is another example of a country that has effectively harnessed the opportunities offered by FDI. FDI has helped prevent Mexico, an oil exporter, from suffering harmful resource curse symptoms. Instead, Mexico is an essential part of the North American value chain in automobiles and electronics. Mexico has leveraged its network of free trade agreements, open investment policies, and skills development to craft important linkages between the domestic private sector and world class foreign companies. In 2000, for example, Mexico's exports of aerospace products were insignificant. By 2015,

the sector had grown to a $5 billion export industry employing some 31,000 people, with 20% annual growth and exports, generated by a cluster of foreign firms linked to domestic companies, projected to reach $12 billion by 2020. This sector represents jobs, opportunities for local firms – and Mexico's ticket to the technological edge.

Across the Atlantic Ocean, tiny, landlocked Lesotho has managed to translate its preferential market access to the EU and US markets into strong export growth. Since it became eligible for AGOA preferences, Lesotho's exports of textiles grew by about 60 percent per year, and the textile and affiliated industries have been an important source of jobs.

III. Effective FDI Needs a Smart Policy Framework

As we see from these examples, FDI, especially in key sectors, can power an economy. But not all FDI is created equal, and FDI alone is not enough to bring development benefits to countries. Spillovers are not automatic. Host countries need solid investment policy frameworks in place in order to capture the benefits of FDI. And they must have a clear vision on the type of FDI they want to attract and foster.

A smart policy framework can help governments to maximize the potential benefits of FDI. A vision and a strategy needs to be complemented by targeted promotion activities to pursue and attract the desired investments. At the same time, governments need to reduce the legal and procedural barriers to FDI – this is an area where the World Bank Group can help. And critically, FDI should be linked with the domestic economy. This can be done through measures that enable local suppliers to upgrade the quality, quantity or price of their production.

Another benefit from FDI is its impact on infrastructure. This effect is two-fold. Expanding the private sector through FDI can lead to greater demand for quality infrastructure. This leads investment opportunities for domestic and foreign companies to build roads and ports and telecommunications and IT infrastructure. FDI can thus have a cascading effect on the economy, as foreign investment leads to opportunities to enhance the private sector through public-private partnerships, the result of which can translate into more investment, which in turn helps boost the domestic private sector. We talked earlier about Vietnam's shift from lower to higher value added investment. Part of this transformation was the government's focus on improving infrastructure, which helped it to move from a destination for textile factories to a location of choice for high-tech investment. Vietnam continues to invest in infrastructure: a new metro will open next year and a major international terminal has opened at the Hanoi airport. In neighboring Malaysia, the large market potential for increased FDI helped stimulate infrastructure investment, which, in turn, helped attract more foreign investment to Malaysia. This is key: economic studies show that a 1 percent improvement in physical infrastructure can yield an extra 1 to 2 percentage points of GDP growth – or more.

Attracting much-needed infrastructure FDI often requires governments to increase transparency in their contracting process, improve predictability and enhance accountability. These measures also have a salutary effect on the business climate, thereby enhancing countries' ability to attract more and higher quality FDI. Sector and utility reforms, coupled with broader governance and regulatory reforms will enable countries to significantly upgrade their private sector potential.

IV. Not all FDI is the same

Many governments ask us: if FDI has so many potential benefits, why are countries who have received it for decades not more advanced? The answer is related not only to smart investment policies. It also has to do with the fact that not all FDI is the same. Nor does it all have the same economic, social and environmental impacts.

Governments on the receiving end of FDI need to analyze the motives of investors. Are they seeking natural resources? Looking to serve domestic markets? Aiming to acquire strategic assets? Or, are they are searching for a home for international production?

These questions are important because different types of FDI generate different types of trade patterns. Natural resource-seeking FDI tends to generate exports of commodities and primary products. On the other end of the spectrum, efficiency-seeking FDI – investment that comes to a country to benefit from factors that enable it to compete in international markets – can help countries move up the value chain.

Take, for instance, the case of Mexico. Efficiency-seeking FDI helped develop its aerospace industry in less than two decades. The sector grew from essentially zero in 2000 to a $5 billion export industry in 2015. The industry employs some 31,000 people and is growing 20% per year. Linkages between foreign and domestic firms supported the industry's growth and helped retain investment.

V. Conclusion

While attracting FDI is critical to development, diversification, and participation in global value chains, it's only a small part of the story. An investment is not a transaction, it is a relationship, and taking active steps to retain investors that bring value is crucial. The real benefits of FDI for a host country appear later on, as foreign firms bring in capital, employ local staff, share technology and know-how, and create spillovers that move a country up the value chain.

In the World Bank Group's Trade & Competitiveness Global Practice, we are actively working with our clients to improve business environments and investment climates of host countries to encourage more FDI. For instance, in 2012, we worked with the Government of Peru to make it easier for tourism-related businesses to operate. By the end of the project, we had shaved 3 years off the business registration process and eliminated 150 unnecessary regulations that were making it difficult for new businesses – both foreign or domestic – to operate. This project has made it possible for a wider variety of firms – both large and small, local and foreign - to participate in the burgeoning tourism industry and to benefit from spillovers that follow major investments from hotel chains.